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## LOCKING THE BOARDROOM DOOR: WHAT CAN GEORGIA COURTS LEARN FROM RECENT DELAWARE POISON PILL DECISIONS?

Alan M. Long\*

### INTRODUCTION

Public corporations have always been plagued by the threat of hostile takeovers.<sup>1</sup> To curb such market volatility and preserve company leadership, directors have turned to certain defense mechanisms—perhaps the most notable being shareholder rights plans called “poison pills.”<sup>2</sup> These shareholder rights plans are flexible, easily adopted, and highly effective in deterring acquisitions, tender offers, and even proxy contests.<sup>3</sup> Moreover, nearly every state has validated the use of poison pills, following the lead of the nation’s corporate hub—Delaware.<sup>4</sup> However, the Delaware Court of Chancery recently drafted an opinion that perhaps

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\* J.D. Candidate 2016, Georgia State University College of Law. I would like to thank my wife, Ashley for her unwavering love and support and for keeping me sane throughout the publication of this note and each day of law school. I would also like to thank my mother, father, and sister, each for continuing to inspire me and push me toward my goals. In addition, I would like to thank Professor Anne Tucker whose advice influenced the development of this topic, and whose feedback polished the final draft, as well as Professor Robert Weber for his invaluable suggestions.

1. See David Ikenberry & Josef Lakonishok, *Corporate Governance Through the Proxy Contest: Evidence and Implications*, 66 J. BUS. 405, 405 (1993); Recent Case, *Corporate Law—Takeover Defenses—Northern District of Georgia Upholds Continuing Director Provision of Poison Pill—Invacare Corp. v. Healthdyne Technologies, Inc.*, 968 F. Supp. 1578 (N.D. Ga. 1997), 111 HARV. L. REV. 1626, 1626 (1998) [hereinafter *Georgia Upholds Continuing Director Provision*] (“Over the past fifteen years, the poison pill has become one of the most widely used takeover defenses.”).

2. E.g., William B. Shearer III, Comment, *Poison Pills: Are Dead Hand Pills Dead in Georgia?*, 50 MERCER L. REV. 809, 809 (1999); Randall S. Thomas, *Judicial Review of Defensive Tactics in Proxy Contests: When Is Using a Rights Plan Right?*, 46 VAND. L. REV. 503, 506 (1993); see also discussion *infra* Part I.A.

3. See *infra* note 23 and accompanying text; see also discussion *infra* Part I.2–3.

4. Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381, 403 (2002) (“The legality of the poison pill is well-established [as] the courts in Delaware and many other states have clearly upheld the poison pill . . . .”); *id.* at 403 n.150 (“There is now no doubt as to the legality of the poison-pill rights plans. The ‘flip-in’ feature of the plan was held, in some early cases, to violate state corporate law. These rulings, however, have now been overruled, either judicially or by legislation explicitly authorizing the flip-in.”) (citing I MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS § 6.03[4], at 6–59 (2001)).

extended this validity too far.<sup>5</sup> The court upheld a unique poison pill with a 10% acquisition trigger that was enacted specifically in anticipation of a proxy contest and strategically designed to restrain only the ability of activist investors to purchase outstanding stock.<sup>6</sup> Such director advocacy may lead down a slippery slope and raises the question of whether other states will continue to follow Delaware's poison pill jurisprudence—particularly Georgia, which has diverged from Delaware corporate law in the past.<sup>7</sup>

This Note addresses that question. First, Part I offers a general overview of poison pills, as well as an account of their legal development in Delaware and Georgia.<sup>8</sup> Next, Part II discusses *Third Point LLC v. Ruprecht*<sup>9</sup>—a recent Delaware Court of Chancery case that could have a significant impact on corporate takeover law.<sup>10</sup> Further, Part II analyzes whether, if faced with a similar fact pattern, Georgia courts would follow the Court of Chancery's lead.<sup>11</sup> Finally, Part III proposes that the court in *Third Point* went too far in its holding.<sup>12</sup> Particularly, the Delaware Court of Chancery opened the door for threatened boardrooms to enact unique poison pills with exceedingly low triggers in the interest of protecting their positions as incumbent directors rather than promoting the interests of the corporation's shareholders.<sup>13</sup> As such, courts, shareholders, and states like Georgia, which have become lost in an idea of boardroom protectionism, should deviate from Delaware jurisprudence and limit the use of such defense mechanisms.<sup>14</sup>

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5. See generally *Third Point LLC v. Ruprecht*, No. CIV.A. 9469-VCP, 2014 WL 1922029 (Del. Ch. May 2, 2014); see also discussion *infra* Part III.

6. See generally *Third Point*, 2014 WL 1922029.

7. See discussion *infra* Part I.B.1.

8. See *infra* Part I.A–B.1.

9. See generally *Third Point*, 2014 WL 1922029.

10. See *infra* Part II.

11. See *infra* Part II.D.

12. See *infra* Part III.

13. See discussion *infra* Part III.

14. See discussion *infra* Part III.

## I. AN OVERVIEW OF POISON PILLS AND THEIR ENFORCEABILITY

A. *Poison Pills Generally*

The term “poison pill” was coined to describe controversial, defensive measures “adopted . . . in response to takeover attempts or in advance of possible takeover attempts”<sup>15</sup> that, when triggered, are “poisonous to the raider.”<sup>16</sup>

Company directors implement poison pills through a shareholder rights plan.<sup>17</sup> When a board of directors elects to use a poison pill as a defensive measure, its members vote to create a preferred share plan.<sup>18</sup> After approval, the plan is typically “recorded as a board resolution or in the company bylaws” and becomes effective immediately.<sup>19</sup> The plan entitles each share of common stock to a “dividend of one right”; accordingly, a right attaches to each individual share and the two become inseparable.<sup>20</sup> In turn, these rights become exercisable upon the occurrence of a predetermined triggering event—generally a potential merger or acquisition, tender offer, or the purchase of a certain percentage of the company’s stock.<sup>21</sup> “Once triggered, the [r]ights . . . detach from the shares and entitle all of the target company’s shareholders . . . to acquire securities at a discount.”<sup>22</sup> The securities that stakeholders may

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15. Suzanne S. Dawson et al., *Poison Pill Defensive Measures*, 42 BUS. LAW. 423, 423 (1987).

16. 1 ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS § 5.01 [A] (7th ed. 2012).

17. *E.g.*, Dawson et al., *supra* note 15, at 423.

18. Shearer, *supra* note 2, at 812; *see also* Lucas O. Harsh, Note, *Dead Hand Poison Pills: Will Georgia Corporations Continue to Issue A Lethal Dose?*, 16 GA. ST. U. L. REV. 665, 667–68 (2000) (noting that a board typically “implements a shareholder rights plan without a shareholder vote”).

19. Shearer, *supra* note 2, at 812.

20. William J. Carney & Leonard A. Silverstein, *The Illusory Protections of the Poison Pill*, 79 NOTRE DAME L. REV. 179, 184 (2003) (“These rights are initially ‘stapled’ to the common stock, in the sense that they can only be transferred with the common stock, and are not immediately exercisable on issue.”); Patrick J. Thompson, Note, *Shareholder Rights Plans: Shields or Gavels?*, 42 VAND. L. REV. 173, 176 (1989) (noting that poison pills “are implemented through the issuance of a pro rata dividend of ‘purchase rights’ to stockholders”).

21. *E.g.*, Velasco, *supra* note 4, at 382. Acquiring twenty percent of a company’s stock will typically trigger a rights plan; however, “[t]rigger levels vary . . . with some [being] as low as 10 percent.” Harsh, *supra* note 18, at 667–68. Moreover, if ownership is threatened, a board can call an emergency meeting to implement a new defensive measure or lower an existing triggering percentage to curb the threat. *Id.* at 668.

22. Velasco, *supra* note 4, at 382; *accord* FLEISCHER & SUSSMAN, *supra* note 16, at § 5.01 [A]

purchase depend on the type of right exercised.<sup>23</sup> Yet, no matter the right exercised, the result can be devastating to a hostile bidder.<sup>24</sup>

### 1. *Poison Pill Variations*

Basic poison pills can be broken down into five categories: flip-over, flip-in, back-end, convertible preferred stock, and voting provisions.<sup>25</sup> Perhaps the most common poison pill category in rights plans are “flip-in” provisions, which allow current shareholders, other than the hostile bidder, to purchase newly issued stock at a discounted rate.<sup>26</sup> This is effective because the surge in ownership, with the bidder precluded from purchasing the new stock, dilutes the acquirer’s ownership.<sup>27</sup> “Flip-over” provisions are also common. These provisions, often triggered by mergers, entitle rights holders to

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(describing how each right detaches from its share and becomes exercisable upon the occurrence of a triggering event).

23. See Thompson, *supra* note 20, at 181–87 (detailing the five types of poison pills that “have been introduced since the early 1980s”); see also discussion *infra* Part I.A.1; discussion *infra* note 25 and accompanying text.

24. Compare Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 209 (2005) (“The poison pill is the most potent of antitakeover defenses.”), with Dawson et al., *supra* note 15, at 426 (“Although poison pills may effectively deter certain inadequate or otherwise undesirable offers, management and boards of directors must recognize that the adoption of poison pills is neither risk free nor guaranteed effective.”), and Carney & Silverstein, *supra* note 20, at 183 (asserting that most rights plans are less effective at deterring hostile bidders than many believe, in part because only a fraction of the initial investment will be lost and “[o]nce the pill’s effectiveness ends, the illness is free to resume its course”).

25. This Note focuses on flip-over and flip-in provisions. However, Suzanne Dawson and her co-authors provide a brief overview of the other three variations:

(iii) Back-end provisions entitling stockholders, except Acquiring Persons, to receive stock and/or debt of the issuer and/or cash generally valued (together with stock retained by the issuer’s stockholders, if not required to be tendered to the issuer) at a premium over market for the issuer’s stock.

(iv) Convertible preferred stock provisions entitling stockholders, except Acquiring Persons, to voting stock in the Acquiring Person as part of any business combination and to redeem their preferred stock for cash payments from the issuer if there is no business combination.

(v) Voting provisions involving the issuance of stock with supervoting rights not available to an Acquiring Person.

Dawson et al., *supra* note 15, at 424. For an in-depth discussion of all five variations, see generally Thompson, *supra* note 20, at 181–87.

26. E.g., Dawson et al., *supra* note 15, at 428; FLEISCHER & SUSSMAN, *supra* note 16, at § 5.01 [B][1] (“Today, the prevalent version of the pill . . . is the standard ‘flip-in/flip-over’ stockholder rights plan.”). Typically, after an acquirer accumulates the specified percentage of stock, every other shareholder is entitled to purchase additional voting stock at 50 percent of its market price. *Id.*

27. Harsh, *supra* note 18, at 668.

purchase the acquirer's stock at a substantial discount—typically at 50%.<sup>28</sup> Flip-over provisions can significantly diminish an acquirer's capital assets because of this discount.<sup>29</sup>

In effect, flip-in and flip-over provisions serve as formidable deterrents.<sup>30</sup> Indeed, when either provision is triggered, “shareholders will find that the rights are valuable and exercise them.”<sup>31</sup> As a result, the acquisition becomes exponentially more costly.<sup>32</sup> Therefore, bidders are greatly discouraged from “accumulating the trigger level through purchase, tender, or the formation of formal voting agreements with other shareholders.”<sup>33</sup>

## 2. *Overcoming Poison Pills*

The only way around a poison pill is to have it removed, and most are retractable.<sup>34</sup> With this in mind, there are three recognized ways to remove a poison pill: (1) negotiate with the target company to retract the pill,<sup>35</sup> (2) appeal to the court by asserting that company

28. Dawson et al., *supra* note 15, at 427. Dawson and her colleagues offer a helpful illustration: [A]ssuming an exercise price of \$150, the standard . . . flip-over poison pill plan would require that, in order for the issuer to consummate a merger into an Acquiring Person, the merger agreement must provide that the rights holders can purchase \$300 worth of the Acquiring Person's common stock for \$150.

*Id.*

29. Thomas, *supra* note 2, at 512.

30. It is important to note that these two provisions are commonly used in conjunction; after a flip-in provision event, if the company engages in any merger negotiations or a substantial sale of its assets, a flip-over provision will trigger and allow every stockholder except the acquirer to purchase “the most senior voting securities” at fifty percent of market price. FLEISCHER & SUSSMAN, *supra* note 16, at § 5.01 [B][1]. Of course, the flip-in provision is generally so effective that the flip-over is superfluous. *Id.* (observing that a flip-in provision's effects have become so unacceptable to hostile bidders that only one has ever been triggered).

31. Thomas, *supra* note 2, at 512; *accord* Velasco, *supra* note 4, at 394, n.88 (observing that “once the rights become exercisable, it becomes irrational to refuse to exercise them, since a shareholder would be subjecting herself to the same economic poison facing the hostile acquiror”).

32. Thomas, *supra* note 2, at 512.

33. Harsh, *supra* note 18, at 668; *accord* Velasco, *supra* note 4, at 383 (“The poison pill derives its effectiveness from this deterrence value—the incumbent management can remain in power because the hostile bidder cannot afford to trigger the poison pill.”).

34. *E.g.*, Shearer, *supra* note 2, at 812. Removing a poison pill is technically known as redemption. *Id.* “Once the pill is redeemed, the rights can no longer affect the stock because they are no longer exercisable.” *Id.* Also, it is important to note that rights plans are only redeemable by the board of directors. *Id.*

35. Velasco, *supra* note 4, at 383. “[T]his is little more than a phantom option; if a friendly transaction were feasible, a hostile bid would not have been necessary.” *Id.* To be sure, copacetic

leadership has breached its fiduciary duty,<sup>36</sup> or (3) wage a proxy contest to displace the incumbent board so that new directors may remove the pill.<sup>37</sup> A proxy contest, however, is generally “the only real option available to most hostile bidders” and warrants further discussion.<sup>38</sup>

A proxy contest is a fight for control of a company. More specifically, it is a direct appeal to voting shareholders governed by SEC regulations.<sup>39</sup> The purpose of the proxy contest is to provide shareholders with enough information about the dissident investors and surrounding context so that they can vote for leadership that best represents the company’s interests.<sup>40</sup> Despite their popularity in the 1950s and 1960s, however, proxy contests became sparse moving into the final quarter of the twentieth century.<sup>41</sup> Then, beginning in the early 1990s in response to the growing number of companies that adopted antitakeover provisions, proxy contests reemerged as a tool for activist shareholders eager to remove unwanted executives.<sup>42</sup> As a result, corporate executives scrambled for a way to defend their positions.

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takeovers are usually cheaper for the purchaser. *Id.* at 383 n.14. As such, hostile takeovers are only pursued where the bidder’s efforts have been hindered or are expected to be. *Id.*

36. *Id.* at 383; see also discussion *infra* Part II.B.

37. Velasco, *supra* note 4, at 383.

38. *Id.* at 384; Dawson et al., *supra* note 15, at 432 (identifying an “[i]ncreased likelihood of proxy contests” as a potential risk of poison pill implementation).

39. Donald E. Schwartz, *The Public-Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. REV. 421, 421 & n.1 (1971). Those rules are codified in 17 C.F.R. § 240.14a. *Id.* at 421 n.1. For an in-depth summary of those rules, as well as the methods of waging a proxy contest, see FLEISCHER & SUSSMAN, *supra* note 16, at § 10.02.

40. Schwartz, *supra* note 39, at 421 (describing the purpose of such “corporate combat” as supplying shareholders with enough information about each side to make an intelligent decision).

41. Thomas, *supra* note 2, at 508. During that time, the tender offer’s popularity grew, and it eclipsed the proxy contest as the preferred method of changing corporate leadership. *Id.* That is to say, due to uncertainty caused by electoral propaganda, shareholders became more willing to sell their shares to discordant investors than to show their support at the ballot box. *See id.*

42. Ikenberry & Lakonishok, *supra* note 1, at 405. Indeed, “in 1987, more than 90% of Fortune 500 firms had antitakeover provisions in their charters.” *Id.* While poison pills have become widespread, however, “[c]orporate America has [also] witnessed an increase in the number of proxy contests and consent solicitations in recent years.” FLEISCHER & SUSSMAN, *supra* note 16, at § 10.01 (illustrating this statement with empirical charts and data).

### 3. *Dead Hand Provisions*

Though basic poison pills are useful for preventing hostile takeovers, historically, when faced with a proxy contest, they did little to ensure a company's board members retained their positions.<sup>43</sup> Thus, boards began adopting continuing director provisions to stay in power.<sup>44</sup> These provisions, commonly referred to as "dead hand provisions," restrict the ability to redeem rights under a share plan, essentially the poison pill, by only permitting the old board to do so and not a new board of directors.<sup>45</sup> Therefore, even if a new board assumes power, its predecessors can activate the pill, diluting the recently acquired holdings and making the displacement infeasible or impossible.<sup>46</sup> This gives the board formidable leverage when negotiating, often allowing it to fend off proxy fights.<sup>47</sup> Indeed, dead hand provisions have evolved into powerful and controversial weapons, becoming perhaps the only "absolute 'show stoppers' in the takeover market."<sup>48</sup>

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43. See FLEISCHER & SUSSMAN, *supra* note 16, at § 5.02 [B] (explaining that, because standard poison pills do not bar a proxy contest, the acquiror can obtain control of the board and exercise its redemption power). It should be noted, however, that basic poison pill varieties can be useful leverage for an incumbent board in the negotiations preceding a proxy contest. See *Third Point LLC v. Ruprecht*, No. CIV.A. 9497-VCP, 2014 WL 1922029, at \*9 (Del. Ch. May 2, 2014) (noting that where a target company anticipated a proxy contest, executive advisors described poison pills as "[e]ffective device[s] to ensure Board involvement in the timing and outcome of a takeover bid or creeping accumulation of control") (second alteration added). Because proxy contests are time-consuming and expensive, dissident shareholders inhibited from hostile acquisition by a rights plan, may be more willing to negotiate a deal before the contest date. *Id.* at 9–10, 14; Velasco, *supra* note 4, at 384.

44. Harsh, *supra* note 18, at 673–74.

45. *Id.* Delayed redemption provisions, also known as "no hand provisions," work in essentially the same way, the only difference being that new board members are prohibited from affecting rights plans for a set term, during which time the original board is free to exercise the rights. Shearer, *supra* note 2, at 811.

46. Shearer, *supra* note 2, at 816 (describing how a dead hand provision would prevent a newly formed board from exercising the redemption right).

47. Thomas, *supra* note 2, at 508; see also *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1283, 1289–90 (Del. 1998) (illustrating how a continuing director feature can thwart a tender offer and proxy contest, leaving legal remedies as the only available option for a hostile bidder).

48. Harsh, *supra* note 18, at 675; cf. FLEISCHER & SUSSMAN, *supra* note 16, at § 5.02 (advocating that while poison pills may be deterrents, they are not a target corporation's panacea).



### B. *The Development of Poison Pills in the Law*

The poison pill has played a dynamic role in the progression of corporate takeover jurisprudence “[s]ince making its legal debut in 1985 . . . .”<sup>49</sup> During that year, the poison pill made an appearance in two Delaware cases: *Unocal Corp. v. Mesa Petroleum Co.*<sup>50</sup> and *Moran v. Household International, Inc.*<sup>51</sup> In *Unocal*, the Delaware Supreme Court addressed whether boards of directors faced with takeover threats should be protected under the business judgment rule by introducing a standard of review.<sup>52</sup> Specifically, the court laid out what became a two-prong test: (1) “a reasonableness test, which is satisfied by a demonstration that the board of directors had reasonable grounds for believing that a danger to corporate policy and effectiveness existed,”<sup>53</sup> and (2) a “proportionality test, which is satisfied by a demonstration that the board of directors’ defensive response was reasonable in relation to the threat posed.”<sup>54</sup> If the court is convinced both prongs are satisfied, the business judgment rule applies, and the court will presume the board’s actions are valid.

Five months after *Unocal*, the Delaware Supreme Court went further and validated poison pills as “legitimate exercise[s] of business judgment.”<sup>55</sup> In *Moran v. Household International, Inc.*, the

49. *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25, 27 (Del. Ch. 1998), *aff’d sub nom.* *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998).

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

51. *Moran v. Household Int’l, Inc.*, 500 A.2d 1346 (Del. 1985).

52. *See Unocal*, 493 A.2d at 953. In *Unocal*, the board of directors rejected Mesa’s tender offer for sixty-four million shares at forty percent below market price. *Id.* at 949–50. In sum, the court concluded that Unocal’s board was faced with a “threat it reasonably perceived to be harmful to the corporate enterprise,” so “its action [was] entitled to the protection of the business judgment rule[.]” *Id.* at 953, 958.

53. *Third Point LLC v. Ruprecht*, No. CIV.A. 9497-VCP, 2014 WL 1922029, at \*16 (Del. Ch. May 2, 2014). This prong “is essentially a process-based review” that can be satisfied “by demonstrating [both] good faith and reasonable investigation.” *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 92 (Del. Ch. 2011); *Paramount Commc’ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1152 (Del. 1990); *see also Unocal*, 493 A.2d at 955.

54. *Third Point*, 2014 WL 1922029, at \*16. This prong consists of its own two-part test: First, were the board’s defensive measures “draconian, by being either preclusive or coercive[?]” *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1367 (Del. 1995). If the court answers no, it must then determine whether the actions taken were “within a range of reasonable responses to the threat.” *Id.* Also, it is important to note that the board of directors bears the burden of proof during both prongs of the *Unocal* standard. *Unocal*, 493 A.2d at 955.

55. *Moran*, 500 A.2d at 1348.

court upheld a rights plan that contained a flip-over provision triggered after either the announcement of a tender offer for 30% of corporate shares or in response to an individual entity or group acquiring 20% of corporate shares.<sup>56</sup> Two disgruntled investors attempted to abrogate the plan, alleging abuse of discretion.<sup>57</sup> The court, however, concluded that the board had acted within its fiduciary authority when adopting the plan even though the board enacted the pill absent an immediate threat.<sup>58</sup> The court also found “the inherent powers of the Board conferred by 8 Del.C. § 141(a), concerning the management of the corporation’s ‘business and affairs’[,] . . . provid[ed] the Board additional authority upon which to enact the Rights Plan.”<sup>59</sup> Moreover, in applying the *Unocal* standard, the court determined that the board’s decision benefited from the business judgment rule.<sup>60</sup>

The Delaware Supreme Court has stood firmly behind its earlier decisions, repeatedly affirming the *Moran* holding and reiterating that instituting poison pills is a legitimate exercise of a board’s discretionary power.<sup>61</sup> However, Delaware courts have refused to validate several directorial responses to threats of proxy contests,<sup>62</sup> including dead hand and no hand provisions, which confine the authority to retract the poison pill to the incumbent board members.<sup>63</sup>

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56. *Id.*

57. *Id.* at 1349.

58. *Id.* at 1350, 1353.

59. *Id.* at 1353.

60. *Id.* at 1357.

61. *See, e.g.,* *Account v. Hilton Hotels Corp.*, 780 A.2d 245, 250–51 (Del. 2001). In that case, “[t]he court recognized that many of the claims were not ‘precisely controlled by *stare decisis*,’ but reasoned that ‘[t]o recognize [the] validity of . . . [such] claim[s] would emasculate the basic holding of *Moran*, both as to this case and *in futuro*, that directors of a Delaware corporation may adopt a rights plan unilaterally.’” *Velasco, supra* note 4, at 395 (citing *Account*, 780 A.2d at 249). *See also* *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1391 (Del. 1995); *Paramount Commc’ns v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1990) (explicitly rejecting “a narrow and rigid construction of *Unocal*”); *Reylon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 185 (Del. 1986) (upholding a back-end provision).

62. *See, e.g.,* *Carmody v. Toll Bros.*, 723 A.2d 1180, 1186 (Del. Ch. 1998). For example, the Chancery held that directors cannot delay shareholder meetings to buy more time to solicit votes nor increase the board’s size to preserve control because such actions are not in the stockholders’ interests. *Id.* at 1186; *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1208 (Del. Ch. 1987).

63. *See generally* *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998); *see also Carmody*, 723 A.2d at 1186 (striking down a dead hand poison pill). For a more detailed discussion of

Notably, in *Quick Turn Design Systems, Inc. v. Shapiro*,<sup>64</sup> the Delaware Supreme Court quashed a delayed redemption provision that prohibited new directors from redeeming plan rights for six months.<sup>65</sup> While the Chancery found that the provision failed under the *Unocal* test as an unreasonable response to a perceived threat,<sup>66</sup> even more significantly, the Delaware Supreme Court found that the provision was against fundamental tenants of corporate law.<sup>67</sup>

### 1. *Poison Pills in Georgia*

Less than a year before Delaware's judiciary invalidated dead hand and no hand provisions, the Northern District of Georgia ruled in favor of such defense mechanisms in 1997.<sup>68</sup> In *Invacare Corp. v. Healthdyne Technologies, Inc.*,<sup>69</sup> Invacare sought a preliminary injunction to nullify Healthdyne's shareholder rights plan.<sup>70</sup> In addition, Invacare proposed a bylaw that, if adopted, would compel Healthdyne's board to rescind the plan's continuing director provision.<sup>71</sup> However, the court upheld the continuing director

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dead hand and no hand poison pills, see *supra* notes 43–48 and accompanying text.

64. *Quickturn Design*, 721 A.2d at 1281.

65. *Id.* at 1287; see also discussion *supra* note 43.

66. *Quickturn Design*, 721 A.2d at 1290.

67. *Id.* at 1291–92.

One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. Section 141(a) requires that any limitation on the board's authority be set out in the certificate of incorporation. The Quickturn certificate of incorporation contains no provision purporting to limit the authority of the board in any way. The Delayed Redemption Provision, however, would prevent a newly elected board of directors from *completely* discharging its fundamental management duties to the corporation and its stockholders for six months . . . . [Indeed, the provision] restricts the board's power in an area of fundamental importance to the shareholders—negotiating a possible sale of the corporation.

*Id.*

68. See *Invacare Corp. v. Healthdyne Techs., Inc.*, 968 F. Supp. 1578 (N.D. Ga. 1997).

69. *Id.*

70. *Id.* at 1579. The provision “require[d] that any redemption or amendment of the rights plan be approved by one or more directors who were members of the Board prior to the adoption of the rights plan, or who were subsequently elected to the Board with the recommendation and approval of the other continuing directors.” *Id.* Thus, “if Healthdyne’s shareholders vote[d] . . . to replace the incumbent directors with Invacare’s slate of directors, the new Board of Directors could not redeem the rights plan because they would not be ‘continuing directors.’” *Id.*

71. *Id.*

feature and found that the proposed bylaw violated Georgia corporate law because it “would infringe upon the board’s [sole] discretion,” which is statutorily prescribed and broad enough to encompass “the authority to include [] continuing directors provisions . . . .”<sup>72</sup> In fact, the court lauded dead hand provisions, declaring that “the concept of continuing directors is an integral part of a takeover defense and is not contrary to public policy in Georgia.”<sup>73</sup>

In the wake of Delaware’s *Quick Turn* opinion, critics questioned the Northern District’s decision to bestow upon directors such broad discretion in adopting dead hand and no hand provisions.<sup>74</sup> Yet, in 2000, Georgia amended its share options statute not to follow Delaware but to cement its own approach to rights plans.<sup>75</sup> Indeed, O.C.G.A. § 12-2-624, “contrary to the Delaware authority, permit[s] limitations on the ability of newly elected directors to withdraw or change [shareholder] plan[s];”<sup>76</sup> albeit now, such limitations may only remain in effect for 180 days from a director’s election.<sup>77</sup>

## II. A MODERN POISON PILL EVOLUTION

More recently, poison pills have reemerged as a focal point of debate following the decision in *Third Point LLC v. Ruprecht*<sup>78</sup> where Delaware’s Court of Chancery upheld a new poison pill variation that specifically discriminates against activist investors.<sup>79</sup> The decision is a hallmark in Delaware jurisprudence that will

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72. *Id.* at 1582 (referencing O.C.G.A. § 14-2-624(c), which “gives the directors of Georgia corporations the sole discretion to determine the terms and conditions of a shareholders rights plan”).

73. *Id.* at 1581. To support its conclusion that dead hand provisions are consistent with Georgia public policy, the court also leaned on the use of “continuing directors” in two other state statutes. *Id.* at 1580–81 (citing O.C.G.A. §§ 14-2-1111, 14-2-1133 (1994)).

74. *See, e.g., Georgia Upholds Continuing Director Provision, supra* note 1, at 1631 (“At a minimum, given the de facto interference with the shareholder franchise posed by continuing director provisions and the Georgia legislature’s express desire to conform to Delaware law, the court should have applied Delaware’s *Blasius* standard and required Healthdyne to show a ‘compelling justification’ for its infringement upon shareholder voting rights.”); Harsh, *supra* note 18, at 685–86.

75. O.C.G.A. § 14-2-624 (2014).

76. *Id.*

77. *Id.*

78. *Third Point LLC v. Ruprecht*, No. CIV.A. 9497-VCP, 2014 WL 1922029 (Del. Ch. May 2, 2014).

79. *Id.* at \*26–27; *see also* description of the poison pill *infra* note 88 and accompanying text.

undoubtedly trickle down from the corporate hub and have far-reaching effects on American corporate law.<sup>80</sup>

### A. *The Facts of Third Point*

In the fall of 2013, Sotheby's<sup>81</sup> realized that Third Point LLC,<sup>82</sup> working with two other activist hedge funds, had acquired approximately nineteen percent of its outstanding stock.<sup>83</sup> Sotheby's anticipated that the investors intended to replace members of its board with their own representatives.<sup>84</sup> Therefore, to gain leverage before an inevitable proxy contest, Sotheby's board adopted a discriminatory rights plan.<sup>85</sup> The poison pill had a relatively new,

80. It is well known that states often look to Delaware when dealing with matters of corporate law. Historically, this convention of imitation has steered many states' assessment of poison pills. Velasco, *supra* note 4, at 400. As a result, many pills have been upheld through reasoning that mimics *Moran* and *Unocal*. See, e.g., *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 845, 849–50 (D. Minn. 1986), *aff'd in part and vacated in part*, 811 F.2d 414 (8th Cir. 1987) (applying the two-part *Unocal* test to determine that the board's decision to keep a rights plan in place “was clearly a reasonable response to the hostile bid, which the Board . . . concluded was inadequate from a financial point of view”); *A. Copeland Enters., Inc. v. Guste*, 706 F. Supp. 1283, 1291 (W.D. Tex. 1989) (“The validity of the poison pill . . . can be viewed in two contexts: its validity at the time of adoption and its continued validity in light of events subsequent to adoption.”). Moreover, several state legislatures have even codified Delaware's common law validation, authorizing the use of poison pills in their statutory scheme. See FLEISCHER & SUSSMAN, *supra* note 16, at § 5.06 [B][2] (listing thirty-four state statutes authorizing boards of directors to use poison pills).

81. Sotheby's is the “oldest auction house in the world” and is a Delaware corporation publicly traded on the New York Stock Exchange. *Third Point*, 2014 WL 1922029, at \*2. In particular, Sotheby's specializes in selling fine art. *Id.* at \*3.

82. Third Point LLC is an activist hedge fund firm managing roughly \$14.5 billion in assets and is known for reshaping the “business policies or capital structure of the companies it invests in.” *Id.* at \*2.

83. *Id.* at \*9. When the case was heard, Third Point controlled 9.62 percent of outstanding shares while the other two acquirers, Trian and Marcato, held about 3 percent and 6.61 percent respectively. *Id.* at \*4, \*12. Further, “Third Point held derivative positions that, if exercised, would increase [their cumulative ownership] to over 20%.” *Id.* at \*7.

84. *Third Point*, 2014 WL 1922029, at \*7–9. Ruprecht predicted on September 4:

We are going to be the target of a proxy fight with activist shareholders. The motivation for that fight is only peripherally about returning capital. It is about being on Sotheby's Board. . . .

. . . .

[T]his is about power, and political gamesmanship with shareholders, not about capital structure. In the event we do not act, my view is that a proxy fight is much harder to win, and a slate of 3–4 new directors would displace current directors.

*Id.* at \*7–8.

85. *Id.* at \*8–11. In a press release, the board claimed that the plan was “intended to protect Sotheby's and its shareholders from efforts to obtain control that are inconsistent with the best interests of the Company and its shareholders.” *Id.* at \*10. However, Ruprecht believed that the board had always

two-tiered structure designed to defend against activist shareholders.<sup>86</sup> Specifically, the plan defined a 10% threshold for all stockholder purchases, except for passive investors<sup>87</sup> who could acquire up to 20% ownership.<sup>88</sup> In addition, the pill contained a one-year term and “qualifying offer” exception.<sup>89</sup>

Over the first quarter of 2014, after Third Point formally announced its plan to “run a slate” of three directors at Sotheby’s annual meeting, the companies negotiated “earnest[ly] in [an] attempt to avoid a proxy contest.”<sup>90</sup> Nevertheless, the two failed to reach amicable terms.<sup>91</sup> Then, when Sotheby’s denied Third Point’s request for a waiver from the plan to acquire 20% ownership, Third Point and its CEO, Daniel Loeb, filed suit.<sup>92</sup>

### B. *The Vice Chancellor’s Analysis*

In the context of Third Point’s request for a preliminary injunction, the primary issues for the court were (1) whether the rights plan and

been in Third Point’s “crosshairs,” and in an email he wrote, “[o]ur job is to be compelling with investors. We will have a big fight re the board composition next summer. Loeb wants to control our board. . . . He’s a scumbag.” *Id.* at \*8, \*10.

86. *Id.* at \*26–27.

87. Passive investors are those whose beneficial ownership is between 5 and 20% of a class of outstanding registered securities who have not acquired or held those securities for the purpose or effect of changing or influencing control of the issuing company. 17 C.F.R. § 240.13d-1 (2015).

88. *Third Point*, 2014 WL 1922029, at \*10. More specifically, the adopted plan had a two-tier structure where “those who report . . . pursuant to Schedule 13G may acquire up to a 20% interest in Sotheby’s . . . [while] [a]ll other stockholders, including those who report their ownership pursuant to Schedule 13D . . . are limited to a 10% stake in the Company before triggering the . . . ‘poison pill.’” *Id.* at \*10. It is important to realize, however, that

“[a] person is eligible to file a Schedule 13G only if, among other things, they have ‘not acquired the securities with any purpose, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect’ and they own less than 20% of the issuer’s securities.”

*Id.* (citing C.F.R. § 240.12d-1(c)).

89. *Third Point*, 2014 WL 1922029, at \*10. The pill would automatically expire in one year unless prolonged by a stockholder vote. *Id.* Further, the qualifying offer exception delineated that “the Rights Plan [would] not apply to an ‘any-and-all’ shares offer for the Company that cashes out all Sotheby’s stockholders and gives them at least 100 days to consider the offer.” *Id.*

90. *Id.* at \*11.

91. *Id.* at \*12–13.

92. *Id.* at \*13–14. For an account of Mr. Loeb’s experience, as well as an interesting criticism of his activist tactics see William D. Cohan, *Little Big Man*, VANITY FAIR, Dec. 2013, <http://www.vanityfair.com/news/2013/12/dan-loeb-cuba-car-accident>.

waiver refusal were a disproportionate response to the threat posed by Third Point, (2) whether Sotheby's gained an impermissible advantage in the upcoming proxy contest, and (3) whether Sotheby's breached its fiduciary duties in adopting and enforcing the rights plan.<sup>93</sup> Vice Chancellor Parsons answered all three questions in the negative.<sup>94</sup>

*1. A Reasonable Reaction—Applying the Unocal Standard*

To assess the board's actions, the Vice Chancellor utilized the two-prong *Unocal* test, ultimately holding that both the poison pill's adoption and subsequent refusal to grant Third Point a waiver were reasonable.<sup>95</sup>

*a. Adopting the Pill*

Applying the first prong, the Vice Chancellor concluded the board likely reached an objectively reasonable determination that Third Point's acquisition of shares was a threat to the company, and, accordingly, the rights plan appeared to be reasonable.<sup>96</sup> Indeed, relying on the advice of its external advisors, the board surmised that three activist investors were attempting to achieve control of the company without paying a premium.<sup>97</sup> Therefore, the plan's adoption was in response to a legitimate threat of "creeping control."<sup>98</sup>

Applying the second prong, Vice Chancellor Parsons held there was adequate probability that the board could demonstrate that adopting the poison pill was a reasonable reaction to the "wolf pack" threat.<sup>99</sup> Specifically, when the board implemented the plan, there

93. *Third Point*, 2014 WL 1922029, at \*14–15.

94. *Id.* at \*22–23, \*27.

95. *Id.* at \*16–17; *see also* *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955, 957 (Del. 1985).

96. *Third Point*, 2014 WL 1922029, at \*17.

97. *Id.* at \*18. Sotheby's advisors were Goldman Sachs Group, Inc. and Wachtell, Lipton, Rosen & Katz who enlightened the board as to the breadth of Third Point, Trian, and Marcato's acquisitions, and further described a poison pill as an "[e]ffective device to ensure Board involvement in the timing and outcome of a takeover bid or creeping accumulation of control." *Id.* at \*9.

98. *Id.* at \*17.

99. *Id.* at \*21.

was an “objectively reasonable” likelihood that Third Point was working with other hedge funds to acquire a control block while avoiding a premium.<sup>100</sup> Accordingly, failure to implement a poison pill or implementing a pill with a trigger greater than 10% would make such an acquisition relatively easy for a small group of activist investors; therefore, the pill was a proportionate response to the threat posed by Third Point.<sup>101</sup>

*b. Refusal to Waive the Trigger*

In applying the first prong of the *Unocal* standard, the court held that allowing Third Point to acquire more than 10% ownership presented at least one legally cognizable threat: “negative control.”<sup>102</sup> To be sure, if Third Point acquired 20% ownership, it would become Sotheby’s largest stockholder by far, exercising effective control without a majority position.<sup>103</sup> The Vice Chancellor specifically noted that this fact, considered with Mr. Loeb’s “aggressive and domineering manner . . . in relation to Sotheby’s, provide[d] an adequate basis for [the board’s] legitimate concern that Third Point would be able to exercise influence sufficient to control certain important corporate actions . . . despite a lack of actual control.”<sup>104</sup>

Coupled with this finding, applying the second prong, the court quickly decided that the plaintiffs had not met their burden to show a reasonable probability the board would be unable to demonstrate that

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100. *Id.* at \*17.

101. *Id.* at \*15, \*17.

102. *Third Point*, 2014 WL 1922029, at \*21. Negative control refers to the situation where an investor who cannot obtain a majority share, nonetheless acquires enough stock to obtain a “veto right,” whereby he can block certain actions that require a substantial vote. *Id.*

103. *Id.* at \*22. Note too, Sotheby’s board collectively only owns 0.87% of the company’s outstanding shares. *Id.* at \*3.

104. *Id.* at \*21–22; see also Gardner Davis, *Keeping Current: Sotheby’s Poison Pill Battle Reshapes World of Shareholder Activism*, BUS. L. TODAY, June 2014, at 2 (highlighting the importance of defendant’s successful portrayal of Loeb in an unfavorable light to the outcome of the case because it was critical to the Vice Chancellor’s acceptance of their “rather tenuous argument that ‘effective negative control’ was a sufficient threat to justify not waiving the pill”); *Third Point LLC v. Ruprecht: Practical Implications of Sotheby’s Two-Tiered Poison Pill Having Survived Preliminary Judicial Review in Delaware*, M&A UPDATE (Hogan Lovells), June 18, 2014, <http://ehoganlovells.com/cv/a1903d9ea9b819613bc203a0d567c559e4981453> [hereinafter *Practical Implications*].



its refusal to waive the 10% cap was a reasonable response to the threat of negative control.<sup>105</sup>

## 2. Proxy Contest Motivation

Vice Chancellor Parsons further concluded that the ensuing proxy fight was not the board's primary motive when adopting the plan.<sup>106</sup> In addition, though Third Point could suffer irreparable harm from losing the proxy contest, the poison pill did not tip the scales because nothing in the plan forced shareholders to vote for incumbent board members.<sup>107</sup> In fact, the Vice Chancellor deduced that the election was "eminently winnable by either side."<sup>108</sup>

## 3. Structure of the Pill

The Vice Chancellor recognized that Third Point had a valid concern in the discriminatory nature of the two-tiered poison pill.<sup>109</sup> Nonetheless, he concluded that "the importance of the 'discriminatory' nature of the challenged rights plan appear[ed] to be

105. *Third Point*, 2014 WL 1922029, at \*22. Vice Chancellor Parsons further stated, "While it is of course conceivable that there is some level of ownership between 10% and 20% that the Board could have allowed Third Point to increase its stake . . . without allowing it to obtain negative control, the 10% cap must be reasonable, not perfect." *Id.*

106. *Id.* at \*23–24. The Vice Chancellor reasoned, in part, that obtaining an advantage in the upcoming proxy contest could not have been the board's primary motive because Third Point enjoyed a "10-to-1 advantage over the incumbent Board in shareholdings," and, as a result, maintained a 50% chance of winning the upcoming proxy contest, even with the 10% trigger in place. *Id.* at \*23. *But see* Memorandum from Paul, Weiss, Rifkind, Wharton & Garrison LLP, *Delaware Court of Chancery Finds Sotheby's Poison Pill Reasonable; Declines to Enjoin Sotheby's Annual Meeting* (May 5, 2014), <http://www.paulweiss.com/media/2478035/5may14alert.pdf> ("Sotheby's board denied Third Point's request because, among other reasons, the waiver would increase Third Point's chances of winning the proxy contest and allow them to exercise disproportionate control over major corporate decisions (even without explicit veto rights).").

107. *Third Point*, 2014 WL 1922029, at \*19 (observing that "the Rights Plan does not impose any consequences on stockholders for voting their shares as they wish").

108. *Id.*

109. *Id.* at \*20. The plaintiffs raised two primary concerns regarding the discriminatory pill: (1) allowing boards to chill future activist activity will damage passive investors who "depend on activists to pursue value-enhancing initiatives, including proxy fights, which often serve the long-term interests of stockholders," and (2) "stockholders should be treated equally." *Id.* at \*26. However, despite acknowledging that the court is "generally sympathetic" to such policy concerns, Vice Chancellor Parsons refused to consider such repercussions before a final hearing on the merits because "they do not present *imminent* threats . . . [but], instead, speak to the long-term reasonableness of the Rights Plan . . ." *Id.*

overstated . . . .”<sup>110</sup> Indeed, the court rejected the plaintiffs’ argument that such a plan’s divergent treatment of activist investors was inherently wrongful; however, the Vice Chancellor was careful not to endorse the pill’s two-tier structure.<sup>111</sup>

### C. Implications

#### 1. Two-Tiered Discriminatory Plans

Though the Vice Chancellor deliberately withheld approval of two-tiered poison pills, his decision certifies that they are not per se invalid.<sup>112</sup> Moreover, the court’s reasoning conveys that pills deliberately targeting activist investors are not unreasonable under the *Unocal* standard.<sup>113</sup> Indeed, such plans may even be a “closer fit” than “garden variety” plans in the face of a hostile acquisition.<sup>114</sup> In addition, the court noted that a pill having a threshold of more than 10% would have been essentially ineffective.<sup>115</sup> As such, poison pills with lower triggers than traditional rights plans are not just reasonable but often necessary.<sup>116</sup>

#### 2. Effective Negative Control

Even where there is no threat of majority acquisition, a board may be able to successfully defend poison pill implementation based on the concept of effective negative control.<sup>117</sup> Though Sotheby’s refusal to grant Third Point a waiver may not have ordinarily held up under the first prong of the *Unocal* test,<sup>118</sup> considering Mr. Loeb’s

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110. *Id.* at \*20.

111. *Id.* at \*26. See Chris O’Leary, *Heading Into a Hot Summer*, THE M&A LAW., June 2014, at 3 (“[T]he decision isn’t ‘a blanket endorsement of a board’s decision to impose a two-trigger rights plan that ‘discriminates’ against activists or a board’s decision not to redeem or waive a two-trigger pill . . . .”).

112. See discussion *supra* Part II.B.3.

113. See *Practical Implications*, *supra* note 104.

114. *Third Point*, 2014 WL 1922029, at \*20.

115. *Id.* at \*21.

116. See *id.*

117. See *Practical Implications*, *supra* note 104.

118. See *id.*

aggressive past conduct, the court concluded that the threat of negative control was legitimate.<sup>119</sup> Thus, a poison pill may be reasonable where an investor acquires an influential portion of company stock and threatens to exercise disproportionate leverage over major corporate decision-making without paying a premium.<sup>120</sup>

### 3. *Motivation Matters*

Delaware jurisprudence has repeatedly invalidated pills implemented for the primary purpose of winning a proxy fight or maintaining boardroom incumbency.<sup>121</sup> It is obvious that Sotheby's adopted its plan largely in preparation for a proxy contest.<sup>122</sup> Nonetheless, the court concluded the upcoming election was not the dominant motive behind the pill.<sup>123</sup> Therefore, if a board appears to have concentrated its efforts on preventing a change in control without paying a premium, it can likely implement a defensive pill that simultaneously protects members' incumbency.<sup>124</sup>

### D. *What Would Georgia Do?*

Like most states, Georgia's poison pill jurisprudence largely conforms to Delaware corporate law.<sup>125</sup> In fact, Georgia has codified

119. See Davis, *supra* note 104, at 2.

120. See *Practical Implications*, *supra* note 104.

121. See, e.g., *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1282 (Del. 1998); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1378 (Del. 1995) (reiterating "concern about defensive actions designed to thwart the essence of corporate democracy by disenfranchising shareholders").

122. See *Third Point LLC v. Ruprecht*, No. CIV.A 9497-VCP, 2014 WL 1922029, at \*7-9 (Del. Ch. May 2, 2014) (describing internal communications where board members predicted a shareholder vote and Third Point's ambition to infiltrate the board and, further discussed tactics for handling the threat).

123. See discussion *supra* Part II.B.2.

124. Sotheby's also greatly benefited its position by offering to allow one or two Third Point representatives onto its board during pre-trial negotiations. Davis, *supra* note 104, at 2; *Third Point*, 2014 WL 1922029, at \*11-12 (describing the negotiations). However, the brunt of those negotiations occurred months after the board adopted the pill. *Id.*

125. In 1988, the U.S. District Court for the Northern District of Georgia held in *West Point-Pepperell v. Farley, Inc.* that certain forms of discriminatory poison pills were invalid under the Georgia code. *W. Point-Pepperell, Inc. v. Farley Inc.*, 711 F. Supp. 1088, 1095 (N.D. Ga. 1988). This decision made Georgia's poison pill law inconsistent with Delaware jurisprudence. See FLEISCHER & SUSSMAN, *supra* note 16, at § 5.06 [B][1]. The very next year, however, the legislature rejected *West Point-Pepperell* and resolved this inconsistency. See *id.* at § 5.06 [B][2] (referencing O.C.G.A. § 14-2-624's 1989 amendment).

Delaware's validation of discriminatory pills.<sup>126</sup> Nevertheless, in *Invacare*, a Georgia federal court veered away from Delaware law and the Georgia legislature further solidified that divergence with an amendment to § 14-2-624.<sup>127</sup> However, in doing so, Georgia law legitimized a poison pill variety that even Delaware's Court of Chancery refused to endorse.<sup>128</sup> By upholding continuing director provisions, Georgia has significantly hindered a discontent shareholder's right to settle their grievances through corporate democracy.<sup>129</sup> Such executive empowerment at the risk of "disenfranchising shareholders" extends beyond the shield of Delaware's business judgment rule.<sup>130</sup> Indeed, there is now a precedent in Georgia that a board of directors has "sole discretion" in selecting the terms of a rights plan—a deference that may preempt fundamental corporate standards.<sup>131</sup>

Georgia has thus established a poison pill law that is more amicable to vulnerable boards.<sup>132</sup> As such, in applying that law to the facts of *Third Point*, a Georgia court would undoubtedly reach the same conclusion as Vice Chancellor Parsons. Specifically, the court would likely hold that both the two-tiered pill and waiver refusal were reasonable reactions to the activist threat and consistent with

126. See O.C.G.A. § 14-2-624 (2014); FLEISCHER & SUSSMAN, *supra* note 16, at § 5.06 [B][1].

127. See *Invacare Corp. v. Healthdyne Techs., Inc.*, 968 F. Supp. 1578, 1581 (N.D. Ga. 1997); O.C.G.A. § 14-2-624 (2014).

128. Compare *Invacare Corp.*, 968 F. Supp. at 1581 (validating continuing director provisions), with *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1283 (Del. 1998) (striking down delayed redemption provision), and *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1186 (Del. Ch. 1998) (striking down dead hand pill).

129. See Harsh, *supra* note 18, at 685 (“[C]ontinuing director provision[s] may have effectively eliminated shareholders’ ability to take their grievances to the ballot box . . . [because] shareholders remain free to vote in a new board, but that new board lacks the power to redeem the rights plan.”); accord *Georgia Upholds Continuing Director Provision*, *supra* note 1, at 1631 (asserting that “such provisions effectively render the election of a new board meaningless”).

130. *Unitrin, Inc., v. Am. Gen. Corp.*, 651 A.2d 1361, 1378 (Del. 1995); see also Velasco, *supra* note 4, at 397 (discussing the significance of proxy contests in Delaware decisions since *Moran*).

131. *Invacare Corp.*, 968 F. Supp. 1578, 1582. The *Invacare* court found the board’s “sole discretion” took “precedence over section 801(b)’s requirement that all limitations on the board’s power be set forth in the articles of incorporation or the bylaws . . .” *Georgia Upholds Continuing Director Provision*, *supra* note 1, at 1629. However, the legislature deleted the statute’s “sole discretion” language in 2000 so the text “must be read in a manner consistent with other provisions of the Code.” O.C.G.A. § 14-2-624 (2014).

132. O.C.G.A. § 14-2-624 (2014).

Georgia law.<sup>133</sup> However, such analysis is likely inconsequential because the anxious board would have likely adopted a continuing directors provision if Sotheby's was incorporated in Georgia, rendering any proxy contest trivial (at least for 180 days).

### III. KEYS TO LOCKING THE BOARDROOM

While poison pills can be useful armaments to a pressured board, allowing them to gain some leverage against hostile activism and intercede in a way that serves the best interest of shareholders, poison pills may impair a business's growth and serve as an unnecessary shield for executive incumbency.<sup>134</sup> Therefore, while discriminatory rights plans are legitimate when facilitating a fiduciary duty, recent corporate law has extended "director primacy"<sup>135</sup> too far. Indeed, the Vice Chancellor's reasoning in *Third Point* could make it easier for incompetent board members to secure their incumbency.<sup>136</sup> Furthermore, *Third Point* involved the legality of a poison pill variation that has never before been challenged.<sup>137</sup> Such blatant discriminatory rights plans contradict grounded principles of corporate law, raise significant policy concerns, and should never be validated under judicial review. Therefore, courts, shareholders, and

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133. Because of Georgia's share options statute, the court would not have to apply the *Unocal* standard. See generally *Invacare Corp.*, 968 F. Supp. 1578 (no mention of *Unocal*). Rather, the court would look to the Georgia Code: section 624(d)(1) authorizes poison pills affecting "beneficial owner[s]" as defined in section 14-2-1110. O.C.G.A. §§ 14-2-624(d)(1) (2014), 14-2-1110(4) (2010). Further, section 624(e)(1) permits "any exclusion from such definition . . ." O.C.G.A. § 14-2-624(e)(1) (2014). Therefore, the Code allows flexibility in determining at whom the poison pill is directed. *Id.*; see also O.C.G.A. § 14-2-624(a) (2014) (empowering the board of directors to choose plan terms including any "conditions precedent"). So, it appears that a pill treating stockholder classes differently would not be inconsistent with the statutory language.

134. Francis J. Aquila & Melissa Sawyer, *Keeping Current: Poison Pills Find New Life as "Raider-Like" Activism is on the Rise*, BUS. L. TODAY, Sept. 2014, at 1 ("[P]oison pills [] serve to provide the target company's board of directors with the time required to fulfill their fiduciary duties and properly respond to 'raider-like' activists.").

135. A term coined by Stephen M. Bainbridge in *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 794 (2002). Alexandros Seretakakis, *Hostile Takeovers and Defensive Mechanisms in the United Kingdom and the United States: A Case Against the United States Regime*, 8 OHIO ST. ENTREPREN. BUS. L.J. 245, 275 (2013).

136. See generally *Third Point LLC v. Ruprecht*, No. CIV.A. 9497-VCP, 2014 WL 1922029 (Del. Ch. May 2, 2014).

137. See discussion *supra* Part II.

state legislatures should take appropriate action to avert Delaware's dangerous jurisprudence.

*A. A Toxic Precedent*

A fundamental pillar of corporate law is a board's accountability to its shareholders. This is exemplified in dissident shareholders' abilities to replace directors whose performance they find unsatisfactory.<sup>138</sup> In fact, the validation of defensive tactics, including poison pills, was premised on the assumption that shareholders who are dissatisfied with a board's decision to block activist offers will replace those directors with a team willing to take different action.<sup>139</sup> Nevertheless, the *Third Point* decision threatens to entrench incumbent boards and serve as a blueprint for directors to validate questionable (perhaps even negligible) decisions.

Corporate law is governed by the precept that shareholders, as owners of the business, should be entitled to make their own investment decisions, as well as any decisions concerning the reallocation of corporate power.<sup>140</sup> As such, when a board of directors adopts a measure "calculated to alter the structure of the corporation, removing decisions in takeover matters from individual stockholders and reposing them in the Board," it has offended the very spirit of corporate law.<sup>141</sup> Nevertheless, the court in *Third Point* found a poison pill reasonable when facing the possibility of negative or creeping control.<sup>142</sup> This undermines the core competency of corporate democracy in favor of a governance model that empowers board members to position themselves as owners of the business.

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138. The power to replace board members is the primary check on directorial decision-making. Indeed, corporate law insulates directors' judgment from judicial scrutiny on the basis that those decisions are monitored by shareholders who will hold their directors accountable. *See, e.g., In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005) (stating that "redress for [board] failures . . . must come . . . through the action of shareholders . . . and not from this Court").

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

140. *See* H. HENN & J. ALEXANDER, *LAW OF CORPORATIONS* 195 (3d ed. 1983); *infra* note 149.

141. *Asarco Inc. v. Court*, 611 F. Supp. 468, 474 (D.N.J. 1985).

142. *Third Point LLC v. Ruprecht*, No. CIV.A. 9497-VCP, 2014 WL 1922029, at \*17 (Del. Ch. May 2, 2014); *see also supra* Part II.C.2.

Because negative and creeping control become “threats” at a very low percentage of ownership,<sup>143</sup> a board can justify adopting a rights plan against any activist investor. Therefore, directors can deter any investment they do not approve. Yet, these are not the “raider-like” activists the poison pill was designed to combat<sup>144</sup>—they are not primarily concerned with acquiring the company at a price detrimental to stockholders; rather, they are focused on ensuring that the company runs in the most profitable manner possible in order to yield a return on their investments.<sup>145</sup>

*B. The Invalidity of Two-tiered Pills*<sup>146</sup>

Two-tiered rights plans, such as the one utilized in *Third Point*, blatantly discriminate against shares of the same class and series. This is particularly troubling because most states’ corporation laws forbid, either expressly or implicitly, such discrimination.<sup>147</sup> Although Vice Chancellor Parsons reasoned that the prejudicial structure of such pills weighs on their long-term reasonableness,<sup>148</sup> to the contrary, such rights plans should be deemed ultra vires.

143. An acquiror could potentially gain a veto right with less than ten percent of the outstanding stock. See *supra* note 102 and accompanying text.

144. See, e.g., Martin Lipton & Paul K. Rowe, *Pills, Polls and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 4–16 (2002) (describing the “historical context of the [antitakeover] debate”); FLEISCHER & SUSSMAN, *supra* note 16, at § 5.04 [A] (describing the hostile 1980s activist environment in which the poison pill was created).

145. See Lucian A. Bebchuk, Essay, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1639 (2013); Kuang-Wei Chueh, *Is Hedge Fund Activism New Hope for the Market?*, 2008 COLUM. BUS. L. REV. 724, 729–32 (2008) (describing the role of activist investors in corporate governance or corporate control).

146. Remember that Vice Chancellor Parsons straddled the fault line of whether such poison pills were valid, careful not to condone Sotheby’s adopting such a pill. *Third Point*, 2014 WL 1922029, at \*26–27; see also *supra* Part II.C.2. Therefore, outside the context of a preliminary injunction, discriminatory rights plans may still be found invalid, not just in other states, but by the Delaware Court of Chancery. *Third Point*, 2014 WL 1922029, at \*26–27.

147. Velasco, *supra* note 4, at 403 n.153 (citing MODEL BUS. CORP. ACT §§ 6.01–.02 (1999)); accord O.C.G.A. § 14-2-602 (2014) (“[A]ll shares of a class or, if applicable, series within a class must have preferences, limitations, and relative rights identical with those of other shares of the same class or series . . .”). Note, too, that although Delaware’s corporate statutes do not have such an express provision, this concept has been adopted through the state’s common law. See *In re Sea-Land Corp. S’holder Litig.*, 642 A.2d 792, 799–800 n.10 (Del. Ch. 1993) (citing cases that demonstrate it has historically been recognized that “absent an express agreement or statute to the contrary, all shares of stock are equal”).

148. *Third Point*, 2014 WL 1922029, at \*20.

*1. An Argument Against Shareholder Discrimination*

Most courts that have struck down poison pills have done so on the basis of discrimination.<sup>149</sup> Specifically, because a typical rights plan allows common shareholders to exercise or transfer a particular right upon the occurrence of a triggering event while prohibiting the acquirer from doing the same, those courts have found poison pills unlawful or unwarranted.<sup>150</sup> Similarly, two-tiered rights plans discriminatorily dilute an “acquiror’s interests, voting rights, and equity . . . .”<sup>151</sup> Moreover, two-tiered poison pills base such discrimination on the type of schedule filed. Therefore, stock from the exact same class will produce different voting capacity depending on whether the purchaser filed a schedule 13D (which activist investors must file) or 13G (which only passive investors may file).<sup>152</sup> For this reason, two-tiered plans brazenly contradict *Moran* where the court premised its decision on the notion that poison pills would only have a “minimal” effect on proxy contests.<sup>153</sup>

In sum, two-tiered rights plans, when exercised, create a drastic change in a corporation’s control structure. They reallocate equity interests and disrupt the voting power among shareholders of the same class. Restructuring of this magnitude cannot be done without an amendment to the corporate charter.<sup>154</sup> Therefore, two-tier poison pills exceed the power granted to a board of directors.

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149. *E.g.*, *W. Point-Pepperell, Inc. v. Farley Inc.*, 711 F. Supp. 1088, 1095 (N.D. Ga. 1988); *Amalgamated Sugar Co. v. NL Indus., Inc.* 644 F. Supp. 1229, 1234 (S.D.N.Y. 1986) (flip-in provision’s discriminatory features violated corporate law); *Minstar Acquiring Corp. v. AMF, Inc.*, 621 F. Supp. 1252, 1258 (S.D.N.Y. 1985) (finding a pill’s non-transferability constraint illegally discriminated among shareholders).

150. *See* cases cited *supra* note 149.

151. Thompson, *supra* note 20, at 195. Like other poison pills, when a triggering event occurs under a two-tier plan, the rights of the acquiror become non-exercisable and non-transferable. *Id.*

152. *See* 17 C.F.R. § 240.13d-1 (2015) (setting forth the requirements for filing schedules 13D and 13G).

153. *Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1355 (Del. 1985).

154. Corporate charters list the rights of shareholders. *See, e.g.*, 8 DEL. CODE ANN. tit. 8, § 151(a) (2006).



## 2. Policy Concerns

Many academics and capitalists opine that hostile takeovers are an essential mechanism for safeguarding the efficiency of corporate governance.<sup>155</sup> Indeed, hedge funds and private equity funds often pursue control in a company because they have innovative ideas on how to realize that company's value.<sup>156</sup> Effectively implementing those changes, however, often requires the ousting of underperforming directors. Nevertheless, armed with a pill that directly limits the ownership of such investors, single-minded directors can obtain considerable leverage and not only frustrate the implementation of these beneficial changes but also ensure their incumbency by creating an obvious advantage in a proxy contest or even deterring a proxy challenge altogether.<sup>157</sup> Moreover, because two-tiered pills allow passive investors to purchase up to 20% of the company's outstanding shares, a shareholder that has filed a schedule 13G can disproportionately affect the company's future.<sup>158</sup> Indeed, the Delaware Court of Chancery suggested in *Third Point* that

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155. See, e.g., Bebchuk, *supra* note 145; Chueh, *supra* note 144; Ronald J. Gilson, Unocal *Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491 (2001).

156. Though a common concern with activist investors is the assumption that they over-emphasize short-term returns at the expense of long-term growth, this concern is largely exaggerated. Bebchuk, *supra* note 145, at 1639. On the contrary, there are ample incentives for activists to pursue strategies that will benefit both the long and short terms. *Id.* at 1643. Therefore, even if activists produce some long-term costs, the benefits of those actions may well exceed any deficiencies. *Id.* at 1664–65. So, this dichotomy necessarily raises the question of activists' motivation: are they concerned with private benefits or earning a return on their investment? If it is the latter, an activist takeover may benefit the company and yield a financial benefit to shareholders. Chueh, *supra* note 144, at 754–58.

157. Proxy challenges are extremely expensive. See generally Daniel M. Friedman, *Expenses of Corporate Proxy Contests*, 51 COLUM. L. REV. 951 (1951). Therefore, where an investor's ownership is limited, the cost of taking control may become too high in light of the increased risk of losing.

158. In particular, schedule 13G's passivity requirement is self-proclaimed, and the decision to switch from schedule 13G to 13D is largely a subjective one; as a consequence, an investor who secretly holds activist intentions may be able "to improperly file a Schedule 13G while quietly planning (or even discretely acting on) its activist intentions." Kristin Giglia, Note, *A Little Letter, A Big Difference: An Empirical Inquiry into Possible Misuse of Schedule 13g/13d Filings*, 116 COLUM. L. REV. 105, 117 (2016). Moreover, "nothing in the rules or statute explicitly precludes Schedule 13G filers from exercising their voice when it comes to voting on corporate matters." *Id.* at 118. Indeed, the only formal restrictions on corporate voting "apply through the ten-day safe-harbor provision, which triggers only when a 13G filer switches to 13D filing (either by choice or by surpassing the twenty percent threshold)." *Id.* at 118 n.74 (citing 17 C.F.R. § 240.13d-1(e)-(f) (2015)).

investors who had filed schedule 13Gs could vote in a proxy contest without forfeiting their passive status.<sup>159</sup>

### C. Preventing the Transmission of a Toxic Precedent

As discussed in the preceding sections, *Third Point*, if applied loosely, could create a precedent that entrenches boards at the expense of corporate democracy and legitimizes a poison pill that is beyond the traditional power vested in directors. However, courts, states, and shareholders can mitigate such negative repercussions, particularly in states such as Georgia that have become rooted in a practice of boardroom protectionism.

#### 1. Courts

Though Vice Chancellor Parsons decided *Third Point* under the *Unocal* test, considering the circumstances, he could have utilized the more exacting *Blasius* standard.<sup>160</sup> “*Blasius* held that the board of directors must provide a ‘compelling justification’ for its actions where the board act[s] ‘for the primary purpose of interfering with the effectiveness of a stockholder vote.’”<sup>161</sup> Indeed, because adopting a two-tiered pill will inhibit an acquirer’s voting rights by capping its ownership of voting shares, Georgia could review such pills under the *Blasius* standard. In fact, *Blasius* may even be more appropriate considering the discriminatory nature of two-tiered plans, especially if adopted in anticipation of a proxy contest. Even so, *Blasius* would not be dispositive. However, it would place a more exacting burden

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159. *Third Point LLC v. Ruprecht*, No. CIV.A. 9469-VCP, 2014 WL 1922029, at \*20 n.37 (Del. Ch. May 2, 2014) (“Based on the evidence presented here, there do not appear to be any restrictions whatsoever on a Schedule 13G filer who wishes to vote for a dissident slate in a proxy contest. Said differently, there is no evidence that a Schedule 13G filer would have to file a Schedule 13D or would otherwise ‘trigger’ the Rights Plan simply because they decide to vote for directors other than those endorsed by the Company.”).

160. Despite the plaintiffs’ urging, Vice Chancellor Parsons determined that *Unocal*, not *Blasius*, was the proper standard of review. *Third Point*, 2014 WL 1922029, at \*15. However, the Vice Chancellor was sympathetic to the plaintiffs’ argument in theory and even noted the slight possibility that *Blasius* could be implicated within the *Unocal* framework. *Id.*

161. *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 330 (Del. Ch. 2010) (quoting *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988)).

on directors to justify their actions, thereby encouraging legitimate use of defensive measures and safeguarding shareholder franchise.

## 2. *States*

An indulgent approach to takeover measures, such as Georgia's, is logical:

Because managers have authority over reincorporation decisions, a state, in order to attract more companies through reincorporations from other states, or alternatively prevent a flight of companies to other states, will adopt a lenient stance towards management takeover rules. Therefore, states have incentives to provide rules that shield the management from hostile takeovers.<sup>162</sup>

Still, states must be careful not to protect corporate management at the expense of shareholders' rights.<sup>163</sup> Indeed, to avoid overpowering directors without shareholder approval, states could amend their statute to require that any rights plan adopted outside the context of an undervalued tender offer must be approved by a majority of the company's shareholders.<sup>164</sup> Under this mandate, a board under fire would still have a prerogative to adopt a poison pill; yet, it would avoid any conflict of interest and ensure that the choice is in the owners' best interest. Therefore, boards would maintain an active

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162. Seretakis, *supra* note 135, at 270–71; *see also* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (progressing the author's "race to the bottom theory" in which he proposes that Delaware's appetite for revenues from incorporations has led the state to establish a lenient corporate law; this subsequently influenced other states that are now competing in a "race to the bottom").

163. Professor Eisenberg said, "[c]orporat[ion] law is constitutional law." Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 4 (1969). Though it may be a slight exaggeration, states should be hesitant to ever defy the core principles of corporate law.

164. This could also be accomplished through corporate procedures, and, in fact some corporations do have "precatory (non-binding) resolutions actually voted on to redeem poison pills or to put them to a stockholder vote." FLEISCHER & SUSSMAN, *supra* note 16, at § 5.02 [C][1]. However, despite an upward trend in these voting resolutions late in the Twentieth Century, they have "diminished rapidly" in more recent years "with only 6 resolutions voted on in 2008 (3 passed), 8 in 2009 (5 passed), [and] 5 in 2010 (2 passed)." *Id.*

role in corporate defense while preserving corporate democracy. Furthermore, requiring shareholders' approval would clarify the judicial review of poison pills. Notably, activist investors could no longer attempt to enjoin a poison pill by asserting that the board's primary purpose in its adoption was to gain unnecessary leverage or ensure incumbency.

Of course, the business judgment rule would still be applicable. As a preliminary matter, the court would review the board's recommendation to adopt the pill under *Unocal*. Also, assuming the pill does not have an automatic expiration, courts could conclude that a board of directors breached its fiduciary duty by not redeeming the plan in an appropriate timeframe.

### 3. *Shareholders*

Regardless of state law and common law jurisprudence, the most significant check on poison pill implementation remains the shareholders themselves. Indeed, equity owners are the pulse of corporations and thereby have the capacity to direct corporate policy and hold management accountable through their right to vote.<sup>165</sup>

"A basic incident of stock ownership is the right to make decisions about who is to control the corporation, and whether to sell shares to a person seeking to acquire control of the company."<sup>166</sup> By and large, any change in management will also mean a change in direction. Transforming corporate practice should not be taken lightly; therefore, an imperative duty of major stockholders is to stay informed. Especially in the context of a rights pill adoption and upcoming proxy contest, owners should carefully consider the financial condition of the company, current managers' attitudes and past behavior, the challenger's proposals, the potential of long-term

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165. Through the voting process "shareholders elect and remove directors, amend articles of incorporation, and approve matters like mergers and consolidations, sale of substantially all assets, and dissolutions." Jonathan Shub, *Shareholder Rights Plans—Do They Render Shareholders Defenseless Against Their Own Management?*, 12 DEL. J. CORP. L. 991, 1034 (1987).

166. *Id.*

costs versus the value of interim returns, and the opinion of any proxy advisory services.<sup>167</sup>

Additionally, in states such as Georgia where continuing director provisions have been validated, dissident shareholders could amend corporate bylaws that prohibit management's use of dead hand pills or even poison pills all together.<sup>168</sup> Although, *Invacare* invalidated a hostile bidder's proposed bylaw that would have dismantled the target's poison pill defense, the court's reasoning would not likely carry over to a bylaw proposed by investors outside the framework of a takeover attempt. However, if the decision was read so broadly as to hold all such mandatory bylaw amendments invalid under Georgia law, the necessity for the state's legislature to take action in preserving the integrity of corporate law cannot be overemphasized.

#### CONCLUSION

Despite the precarious nature of poison pills, the United States boasts one of the most successful economies in the world—a position it has achieved without allowing investors to acquire companies unqualifiedly. Indeed, the U.S. market will never bow to the potential dangers of unchallenged takeover bids, nor should it. Accordingly, poison pills are an enduring stamp on corporate America; yet, they should never be able to swallow the cornerstones of corporate law. The Delaware Court of Chancery's decision in *Third Point*, however, threatens to do just that if applied too broadly. Therefore, it is time to deviate from director primacy and place the power to alter corporate structure back in the hands of shareholders. Such reform is crucial to the preservation of corporate constitutionalism, especially in states like Georgia where managerial favoritism runs rampant.

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167. Perhaps most notable, Institutional Shareholder Services, Inc. (ISS) examines poison pills under a formal rubric to ultimately recommend voting "Against" or "Withhold" in an election. INSTITUTIONAL SHAREHOLDER SERVS. INC., 2013 SRI U.S. PROXY VOTING GUIDELINES (2013); *see also* FLEISCHER & SUSSMAN, *supra* note 16, at § 5.02 [C][1] (listing the factors considered in ISS's review).

168. Remember, according to Georgia law, dead hand provisions can only remain non-redeemable for 180 days. O.C.G.A. § 14-2-624 (2014). Thus, the preceding voting discussion is still effective and perhaps even more important in Georgia.