Best of Case Law – Reading materials

Contents

Class 1: The Purpose of the Corporation (*Dodge v. Ford Motor Company*) 1
James Fallows, *How the World Works*, The Atlantic (December 1993)........................... 2
***Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919)**... 10
Class 2: Shareholders versus Directors (*Blasius Industries, Inc. v. Atlas Corp.*)............... 15
Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651(Del. 1988) 17

Class 1: The Purpose of the Corporation (*Dodge v. Ford Motor Company*)

Dodge v. Ford Motor Company is a great case. It is important because its ruling touches on a question at the very core of corporate law: what is the purpose of the corporation? Is it exclusively to make the most money for shareholders? (And if so – making the most money long-term or short-term?) Or perhaps it is also permissible – or even required – that the corporation would act in the interests of other stakeholders – employees, creditors, customers, the local community, or the nation in which it is incorporated?

But there is another reason why *Dodge v. Ford Motor Company* is a great case: the parties are pretending to act for reasons different than those that really motivate them. As we will see in class, the plaintiff and defendant present their interests in ways that don't make sense once you think things through. And read narrowly, the court's decision seems almost arbitrary and in contrast to established law. But once you understand the entire context, the court ruling can be seen as a clever way to maintain both the letter and the spirit of established law.

But no case is perfect. The main weakness of *Dodge* is that it is not well-written; indeed, it is quite boring to read. Another weakness is that the actual legal question it discusses is a narrow one that requires knowing some corporate law to understand. Therefore, though I am including the text of the case for you to read ahead of class, it is not the main assignment and you should not feel frustrated if it's not clear to you. I will explain the case in class.

Rather, the main reading assignment ahead of class is an excerpt from an old magazine article, about an economist you may never have heard about – Friedrich List. I think this is a more enjoyable reading, and it will give you background for a discussion on the big policy question *Dodge* tackles: whose interests should the corporation serve?

No doubt you have heard of Adam Smith and later classical economists who espoused free-market economics, based on the idea that self-interested behavior by market participants enriches society as a whole. The line of corporate law doctrine that fits with this worldview is the norm that a corporation should operate solely for the purpose of its shareholders, and that this would ultimately benefit all other stakeholders (employees, customers, society as a whole, etc.).

Friedrich List is a leading intellectual force behind an opposing view, which is why I ask that you read the article to understand the main differences between his world view and that of his free-market opponents (which he called the “cosmopolitans”). While List is not widely known today, his work is credited with influencing the thinking of several policy makers and leaders, including China’s Deng Xiaoping.

In some ways, List appears more relevant to political debate today – with the rise of populist politicians in several countries including the U.S. – than it was when the article was written. But in other ways, this article is very much a product of its time. To a contemporary reader it may appear odd how much Japan and Germany are mentioned in the article compared to other countries (for example, China). But this was very typical of American policy analysis (and popular culture) in the 1980s. At that time, the American economy was relatively stagnant, while the economies of Japan and Germany were booming. The US had a large trade deficit with these countries, with cheaper German and Japanese imports crowding out a shrinking American industry, and German and Japanese firms used the dollars they acquired from the deficit to acquire iconic American assets. The result was fear of those two countries on one hand, and a desire to mimic them on the other hand. The article is in the tail end of that trend; by the 1990s Japan entered a prolonged recession, the German economy slowed under the costs of the reunification of West and East Germany, and the American economy prospered again. You may be more familiar with a reincarnation of this trend, in the 2000s and early 2010s, this time focused on China.

James Fallows, *How the World Works*, The Atlantic (December 1993)

[This is an excerpt from the article, which is available at: https://www.theatlantic.com/magazine/archive/1993/12/how-the-world-works/305854/]

In Japan in the springtime of 1992 a trip to Hitotsubashi University, famous for its economics and business faculties, brought me unexpected good luck. Like several other Japanese universities, Hitotsubashi is almost heartbreaking in its cuteness. The road from the station to the main campus is lined with cherry trees, and my feet stirred up little puffs of white petals. Students glided along on their bicycles, looking as if they were enjoying the one stress-free moment of their lives.

They probably were. In surveys huge majorities of students say that they study "never" or "hardly at all" during their university careers. They had enough of that in high school.

I had gone to Hitotsubashi to interview a professor who was making waves. Since the end of the Second World War, Japanese diplomats and businessmen have acted as if the American economy should be the model for Japan's own industrial growth. Not only should Japanese industries try to catch up with America's lead in technology and production but also the nation should evolve toward a standard of economic maturity set by the United States. Where Japan's economy differed from the American model—for instance, in close alliances between corporations which U.S. antitrust laws would forbid—the difference should be considered temporary, until Japan caught up.

Through the 1980s a number of foreign observers challenged this assumption, saying that Japan's economy might not necessarily become more like America's with the passing years. Starting in 1990 a number of Japanese businessmen and scholars began publicly saying the same thing, suggesting that Japan's business system might be based on premises different from those that prevailed in the West. Professor Iwao Nakatani, the man I went to Hitotsubashi to meet, was one of the most respected members of this group, and I spent the afternoon listening to his argument while, through the window I watched petals drifting down.

On the way back to the station I saw a bookstore sign advertising Western-language books for sale. I walked to the back of the narrow store and for the thousandth time felt both intrigued and embarrassed by the consequences of the worldwide spread of the English language. In row upon row sat a jumble of books that had nothing in common except that they were published in English. Self-help manuals by Zig Ziglar. Bodice-rippers from the Harlequin series. A Betty Crocker cookbook. The complete works of Sigmund Freud. One book by, and another about, Friedrich List.

Friedrich List! For at least five years I'd been scanning used-book stores in Japan and America looking for just these books, having had no luck in English-language libraries. I'd scoured stores in Taiwan that specialized in pirated reprints of English-language books for about a tenth their original cost. I'd called the legendary Strand bookstore, in Manhattan, from my home in Kuala Lumpur, begging them to send me a note about the success of their search (it failed) rather than make me wait on hold. In all that time these were the first books by or about List I'd actually laid eyes on.

One was a biography, by a professor in the north of England. The other was a translation, by the same professor, of a short book List had written in German. Both were slim volumes, which, judging by the dust on their covers, had been on the shelf for years. I gasped when I opened the first book's cover and saw how high the price was—9,500 yen, about $75. For the set? I asked hopefully. No, apiece, the young woman running the store told me. Books are always expensive in Japan, but even so this seemed steep. No doubt the books had been priced in the era when one dollar was worth twice as many yen as it was by the time I walked into the store. I opened my wallet, pulled out a 10,000-yen note, took my change and the biography, and left the store. A few feet down the sidewalk I turned around, walked back to the store, and used the rest of my money to buy the other book. I would always have regretted passing it up.

Why Friedrich List? The more I had heard about List in the preceding five years, from economists in Seoul and Osaka and Tokyo, the more I had wondered why I had virtually never heard of him while studying economics in England and the United States. By the time I saw his books in the shop beneath the cherry trees, I had come to think of him as the dog that didn't bark. He illustrated the strange self-selectivity of Anglo-American thinking about economics.

I emphasize "Anglo-American" because in this area the United Kingdom and the United States are like each other and different from most of the rest of the world. The two countries have dominated world politics for more than a century, and the dominance of the English language lets them ignore what is being said and thought overseas—and just how isolated they have become. The difference shows up this way: The Anglo-American system of politics and economics, like any system, rests on certain principles and beliefs. But rather than acting as if these are the best principles, or the ones their societies prefer, Britons and Americans often act as if these were the only possible principles and no one, except in error, could choose any others. Political economics becomes an essentially religious question, subject to the standard drawback of any religion—the failure to understand why people outside the faith might act as they do.

To make this more specific: Today's Anglo-American world view rests on the shoulders of three men. One is Isaac Newton, the father of modern science. One is Jean-Jacques Rousseau, the father of liberal political theory. (If we want to keep this purely Anglo-American, John Locke can serve in his place.) And one is Adam Smith, the father of laissez-faire economics. From these founding titans come the principles by which advanced society, in the Anglo-American view, is supposed to work. A society is supposed to understand the laws of nature as Newton outlined them. It is supposed to recognize the paramount dignity of the individual, thanks to Rousseau, Locke, and their followers. And it is supposed to recognize that the most prosperous future for the greatest number of people comes from the free workings of the market. So Adam Smith taught, with axioms that were enriched by David Ricardo, Alfred Marshall, and the other giants of neoclassical economics.

The most important thing about this summary is the moral equivalence of the various principles. Isaac Newton worked in the realm of fundamental science. Without saying so explicitly, today's British and American economists act as if the economic principles they follow had a similar hard, provable, undebatable basis. If you don't believe in the laws of physics—actions create reactions, the universe tends toward greater entropy—you are by definition irrational. And so with economics. If you don't accept the views derived from Adam Smith—that free competition is ultimately best for all participants, that protection and interference are inherently wrong—then you are a flat-earther.

Outside the United States and Britain the matter looks quite different. About science there is no dispute. "Western" physics is the physics of the world. About politics there is more debate: with the rise of Asian economies some Asian political leaders, notably Lee Kuan Yew, of Singapore, and several cautious figures in Japan, have in effect been saying that Rousseau's political philosophy is not necessarily the world's philosophy. Societies may work best, Lee and others have said, if they pay less attention to the individual and more to the welfare of the group.

But the difference is largest when it comes to economics. In the non-Anglophone world Adam Smith is merely one of several theorists who had important ideas about organizing economies. In most of East Asia and continental Europe the study of economics is less theoretical than in England and America (which is why English-speakers monopolize Nobel Prizes) and more geared toward solving business problems.

In Japan economics has in effect been considered a branch of geopolitics—that is, as the key to the nation's strength or vulnerability in dealing with other powers. From this practical-minded perspective English-language theorists seem less useful than their challengers, such as Friedrich List.

Two Clashing World Views

Britons and Americans tend to see the past two centuries of economics us one long progression toward rationality and good sense. In 1776 Adam Smith's The Wealth of Nations made the case against old-style mercantilism, just as the Declaration of Independence made the case against old-style feudal and royal domination. Since then more and more of the world has come to the correct view—or so it seems in the Anglo-American countries. Along the way the world has met such impediments as neo-mercantilism, radical unionism, sweeping protectionism, socialism, and, of course, communism. One by one the worst threats have given way. Except for a few lamentable areas of backsliding, the world has seen the wisdom of Adam Smith's ways.

Yet during this whole time there has been an alternative school of thought. The Enlightenment philosophers were not the only ones to think about how the world should be organized. During the eighteenth and nineteenth centuries the Germans were also active—to say nothing of the theorists at work in Tokugawa Japan, late imperial China, czarist Russia, and elsewhere.

The Germans deserve emphasis—more than the Japanese, the Chinese, the Russians, and so on because many of their philosophies endure. These did not take root in England or America, but they were carefully studied, adapted, and applied in parts of Europe and Asia, notably Japan. In place of Rousseau and Locke the Germans offered Hegel. In place of Adam Smith they had Friedrich List.

The German economic vision differs from the Anglo-American in many ways, but the crucial differences are these:

* *"Automatic" growth versus deliberate development*. The Anglo-American approach emphasizes the unpredictability and unplannability of economics. Technologies change. Tastes change. Political and human circumstances change. And because life is so fluid, attempts at central planning are virtually doomed to fail. The best way to "plan," therefore is to leave the adaptation to the people who have their own money at stake. These are the millions of entrepreneurs who make up any country's economy. No planning agency could have better information than they about the direction things are moving, and no one could have a stronger incentive than those who hope to make a profit and avoid a loss. By the logic of the Anglo-American system, if each individual does what is best for him or her, the result will be what is best for the nation as a whole.

Although List and others did not use exactly this term, the German school was more concerned with "market failures." In the language of modern economics these are the cases in which normal market forces produce a clearly undesirable result. The standard illustration involves pollution. If the law allows factories to dump pollutants into the air or water, then every factory will do so. Otherwise, their competitors will have lower costs and will squeeze them out. This "rational" behavior will leave everyone worse off. The answer to such a market failure is for the society—that is, the government—to set standards that all factories must obey.

Friedrich List and his best-known American counterpart, Alexander Hamilton, argued that industrial development entailed a more sweeping sort of market failure. Societies did not automatically move from farming to small crafts to major industries just because millions of small merchants were making decisions for themselves. If every person put his money where the return was greatest, the money might not automatically go where it would do the nation the most good.

For it to do so required a plan, a push, an exercise of central power. List drew heavily on the history of his times—in which the British government deliberately encouraged British manufacturing and the fledgling American government deliberately discouraged foreign competitors.

This is the gist of List's argument, from *The Natural System of Political Economy*, which he wrote in five weeks in 1837:

> The cosmopolitan theorists [List's term for Smith and his ilk] do not question the importance of industrial expansion. They assume, however, that this can be achieved by adopting the policy of free trade and by leaving individuals to pursue their own private interests. They believe that in such circumstances a country will automatically secure the development of those branches of manufacture which are best suited to its own particular situation. They consider that government action to stimulate the establishment of industries does more harm than good....
>
> The lessons of history justify our opposition to the assertion that states reach economic maturity most rapidly if left to their own devices. A study of the origin of various branches of manufacture reveals that industrial growth may often have been due to chance. It may be chance that leads certain individuals to a particular place to foster the expansion of an industry that was once small and insignificant—just as seeds blown by chance by the wind may sometimes grow into big trees. But the growth of industries is a process that may take hundreds of years to complete and one should not ascribe to sheer chance what a nation has achieved through its laws and institutions. In England Edward III created the manufacture of woolen cloth and Elizabeth founded the mercantile marine and foreign trade. In France Colbert was responsible for all that a great power needs to develop its economy. Following these examples every responsible government should strive to remove those obstacles that hinder the progress of civilisation and should stimulate the growth of those economic forces that a nation carries in its bosom.

* *Consumers versus producers*. The Anglo-American approach assumes that the ultimate measure of a society is its level of consumption. Competition is good, because it kills off producers whose prices are too high. Killing them off is good, because more-efficient suppliers will give the consumer a better deal. Foreign trade is very good, because it means that the most efficient suppliers in the whole world will be able to compete. It doesn't even matter why competitors are willing to sell for less. They may really be more efficient; they may be determined to dump their goods for reasons of their own. In either case the consumer is better off. He has the ton of steel, the cask of wine, or—in today's terms—the car or computer that he might have bought from a domestic manufacturer, plus the money he saved by buying foreign goods.

In the Friedrich List view, this logic leads to false conclusions. In the long run, List argued, a society's well-being and its overall wealth are determined not by what the society can buy but by what it can make. This is the corollary of the familiar argument about foreign aid: Give a man a fish and you feed him for a day. Teach him how to fish and you feed him for his life.

List was not concerned here with the morality of consumption. Instead he was interested in both strategic and material well-being. In strategic terms nations ended up being dependent or independent according to their ability to make things for themselves. Why were Latin Americans, Africans, and Asians subservient to England and France in the nineteenth century? Because they could not make the machines and weapons Europeans could.

In material terms a society's wealth over the long run is greater if that society also controls advanced activities. That is, if you buy the ton of steel or cask of wine at bargain rates this year, you are better off, as a consumer, right away. But over ten years, or fifty, you and your children may be stronger as both consumers and producers if you learn how to make the steel and wine yourself. If you can make steel rather than just being able to buy it, you'll be better able to make machine tools. If you're able to make machine tools, you'll be better able to make engines, robots, airplanes. If you're able to make engines and robots and airplanes, your children and grandchildren will be more likely to make advanced products and earn high incomes in the decades ahead.

The German school argued that emphasizing consumption would eventually be self-defeating. It would bias the system away from wealth creation—and ultimately make it impossible to consume as much. To use a homely analogy: One effect of getting regular exercise is being able to eat more food, just as an effect of steadily rising production is being able to consume more. But if people believe that the reason to get exercise is to permit themselves to eat more, rather than for longer term benefits they will behave in a different way. List's argument was that developing productive power was in itself a reward. "The forces of production are the tree on which wealth grows," List wrote in another book, called *The National System of Political Economy*.

> The tree which bears the fruit is of greater value than the fruit itself.... The prosperity of a nation is not ... greater in the proportion in which it has amassed more wealth (ie, values of exchange), but in the proportion in which it has more developed its powers of production.

* *Process versus result*. In economics and politics alike the Anglo-American theory emphasizes how the game is played, not who wins or loses. If the rules are fair, then the best candidate will win. If you want better politics or a stronger economy, you should concentrate on reforming the rules by which political and economic struggles are waged. Make sure everyone can vote; make sure everyone can bring new products to market. Whatever people choose under those fair rules will by definition be the best result. Abraham Lincoln or Warren Harding, Shakespeare or Penthouse—in a fair system whatever people choose will be right.

The government's role, according to this outlook, is not to tell people how they should pursue happiness or grow rich. Rather, its role is that of referee—making sure no one cheats or bends the rules of "fair play," whether by voter fraud in the political realm or monopoly in the economic.

In the late twentieth century the clearest practical illustration of this policy has been the U.S. financial market. The government is actively involved—but only to guard the process, not to steer the results. It runs elaborate sting operations to try to prevent corporate officials from trading on inside information. It requires corporations to publish detailed financial reports every quarter, so that all investors will have the same information to work from. It takes companies to court—IBM, AT&T—whenever they seem to be growing too strong and stunting future competitors. It exposes pension-fund managers to punishment if they do not invest their assets where the dividends are greatest.

These are all ways of ensuring that the market will "get prices right," as economists say, so that investments will flow to the best possible uses. Beyond that it is up to the market to decide where the money goes. Short-term loans to cover the budget deficits in Mexico or the United States? Fine. Long-term investments in cold-fusion experimentation? Fine. The market will automatically assign each prospect the right price. If fusion engines really would revolutionize the world, then investors will voluntarily risk their money there.

The German view is more paternalistic. People might not automatically choose the best society or the best use of their money. The state, therefore, must be concerned with both the process and the result. Expressing an Asian variant of the German view, the sociologist Ronald Dore has written that the Japanese—"like all good Confucianists"—believe that "you cannot get a decent, moral society, not even an efficient society, simply out of the mechanisms of the market powered by the motivational fuel of self-interest." So, in different words, said Friedrich List.

* *Individuals versus the nation*. The Anglo-American view focuses on how individuals fare as consumers and on how the whole world fares as a trading system. But it does not really care about the intermediate levels between one specific human being and all five billion—that is, about communities and nations.

This criticism may seem strange, considering that Adam Smith called his mighty work *The Wealth of Nations*. It is true that Smith was more of a national-defense enthusiast than most people who now invoke his name. For example, he said that the art of war was the "noblest" of the arts, and he approved various tariffs that would keep defense-related industries strong—which in those days meant sailcloth making. He also said that since defense "is of much more importance than opulence, the act of navigation is, perhaps, the wisest of all the commercial regulations of England." This "act of navigation" was, of course, the blatantly protectionist legislation designed to restrict the shipment of goods going to and from England mostly to English ships.

Still, the assumption behind the Anglo-American model is that if you take care of the individuals, the communities and nations will take care of themselves. Some communities will suffer, as dying industries and inefficient producers go down, but other communities will rise. And as for nations as a whole, outside the narrow field of national defense they are not presumed to have economic interests. There is no general "American" or "British" economic interest beyond the welfare of the individual consumers who happen to live in America or Britain.

The German view is more concerned with the welfare, indeed sovereignty, of people in groups—in communities, in nations. This is its most obvious link with the Asian economic strategies of today. Friedrich List fulminated against the "cosmopolitan theorists," like Adam Smith, who ignored the fact that people lived in nations and that their welfare depended to some degree on how their neighbors fared. In the real world happiness depends on more than how much money you take home. If the people around you are also comfortable (though, ideally, not as comfortable as you), you are happier and safer than if they are desperate. This, in brief, is the case that today's Japanese make against the American economy: American managers and professionals live more opulently than their counterparts in Japan, but they have to guard themselves, physically and morally, against the down-and-out people with whom they share the country.

In the German view, the answer to this predicament is to pay explicit attention to the welfare of the nation. If a consumer has to pay 10 percent more for a product made by his neighbors than for one from overseas, it will be worse for him in the short run. But in the long run, and in the broadest definitions of well-being, he might be better off. As List wrote in *The National System of Political Economy*

> Between each individual and entire humanity, however, stands the NATION, with its special language and literature, with its peculiar origin and history, with its special manners and customs, laws and institutions, with the claims of all these for existence, independence, perfection, and continuance for the future, and with its separate territory; a society which, united by a thousand ties of mind and of interests, combines itself into one independent whole.

Economic policies, in the German view, will be good or bad depending on whether they take into account this national economic interest. Which leads to

* *Business as peace versus business as war*. By far the most uplifting part of the Anglo-American view is the idea that everyone can prosper at once. Before Adam Smith, the Spanish and Portuguese mercantilists viewed world trade as a kind of battle. What I won, you lost. Adam Smith and David Ricardo demonstrated that you and I could win at the same time. If I bought your wine and you bought my wool, we would both have more of what we wanted, for the same amount of work. The result would be the economist's classic "positive sum" interaction. Your well-being and my well-being added together would be greater than they were before our trade.

The Germans had a more tragic, or "zero sum"-like, conception of how nations dealt with each other. Some won; others lost. Economic power often led to political power, which in turn let one nation tell others what to do. Since the Second World War, American politicians have often said that their trading goal is a "level playing field" for competition around the world. This very image implies a horizontal relationship among nations, in which they all good-naturedly joust as more or less equal rivals. "These horizontal metaphors are fundamentally misleading," the American writer John Audis has written in the magazine *In These Times*.

> Instead of being grouped horizontally on a flat field, nations have always been organized vertically in a hierarchical division of labor. The structure of the world economy more accurately resembles a pyramid or a cone rather than a plane. In the 17th century, the Dutch briefly stood atop the pyramid. Then, after a hundred year transition during which the British and French vied for supremacy, the British emerged in 1815 as the world's leading industrial and financial power, maintaining their place through the end of the century. Then, after about a forty-year transition, the U.S. came out of World War II on top of the pyramid. Now we are in a similar period of transition from which it is likely, after another two decades, that Japan will emerge as the leading industrial power.

The same spirit and logic run through List's arguments. Trade is not just a game. Over the long sweep of history some nations lose independence and control of their destiny if they fall behind in trade. Therefore nations must think about it strategically, not just as a matter of where they can buy the cheapest shirt this week.

In *The Natural System of Political Economy*, List included a chapter on this theme, "The Dominant Nation." Like many other things written about Britain in the nineteenth century, it makes bittersweet reading for twentieth-century Americans. "England's manufactures are based upon highly efficient political and social institutions, upon powerful machines, upon great capital resources, upon an output larger than that of all other countries, and upon a complete network of internal transport facilities," List said of the England of the 1830s, as many have said of the United States of the 1950s and 1960s.

> A nation which makes goods more cheaply than anyone else and possesses immeasurably more capital than anyone else is able to grant its customers more substantial and longer credits than anyone else....By accepting or by excluding the import of their raw materials and other products, England—all powerful as a manufacturing and commercial country—can confer great benefits or inflict great injuries upon nations with relatively backward economies.

This is what England lost when it lost "dominance," and what Japan is gaining now.

* *Morality versus power*. By now the Anglo-American view has taken on a moral tone that was embryonic when Adam Smith wrote his book. If a country disagrees with the Anglo-American axioms, it doesn't just disagree: it is a "cheater." Japan "cheats" the world trading system by protecting its rice farmers. America "cheats" with its price supports for sugar-beet growers and its various other restrictions on trade. Malaysia "cheated" by requiring foreign investors to take on local partners. And on and on. If the rules of the trading system aren't protected from such cheating, the whole system might collapse and bring back the Great Depression.

In the German view, economics is not a matter of right or wrong, or cheating or playing fair. It is merely a matter of strong or weak. The gods of trade will help those who help themselves. No code of honor will defend the weak, as today's Latin Americans and Africans can attest. If a nation decides to help itself—by protecting its own industries, by discriminating against foreign products—then that is a decision, not a sin. […]

* * *

Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919)

[The Ford Motor Company ("FMC") was founded in 1903 by a number of investors, including Henry Ford and brothers John F. Dodge and Horace E. Dodge ("the Dodge brothers"). Henry Ford, who held a 58% interest in FMC, was also FMC's President and a director on its board. The Dodge brothers held a 10% interest, were not on the board of directors nor employed by FMC.

FMC's business strategy was focused on mass-market cars that were lower priced but appealed to a larger group of potential customers. To afford to sell cars at a low price, FMC focused on mass production of cars and vertical integration (owning the businesses that produced the raw materials needed to produce cars). These allowed it to continuously reduce the cost of its cars, and the lower costs allowed selling the car at a lower price, making its cars affordable to customers who were previously priced-out. For example, according to Wikipedia, the standard Model T 4-seat open tourer of 1909 cost $850 (equivalent to $20,513 today). The price dropped to $550 in 1913 (equivalent to $12,067 today); to $440 in 1915 (equivalent to $9,431 today); and to $290 (equivalent to $3,258 today) in the 1920s.

Beginning in 1911, regular annual dividends were $1.2M. In addition, between 1913 and 1915 the company paid special dividends of $10-11M each year. Then, in 1916, Henry Ford announced that FMC would no longer pay special dividends and that profits would be retained to pay for the new River Rouge plant, which will allow FMC to expand its production capacity; to double employees' salaries; and to cut the price of cars.

The Dodge brothers sued: (1) for a decree requiring FMC to distribute to stockholders at least 75% of the accumulated cash surplus, and to distribute in the future all of its earnings "except such as may be reasonably required for emergency purposes"; and (2) to enjoin the construction of the River Rouge plant.]

[…] [The court rejects plaintiffs' arguments that FMC violated a state law ceiling on a corporation's capital; that FMC exceeded the activities it was authorized to conduct (*ultra vires*); or that FMC violated antitrust laws.]

As we regard the testimony as failing to prove any violation of anti-trust laws or that the alleged policy of the company, if successfully carried out, will involve a monopoly other than such as accrues to a concern which makes what the public demands and sells it at a price which the public regards as cheap or reasonable, the case for plaintiffs must rest upon the claim, and the proof in support of it, that the proposed expansion of the business of the corporation, involving the further use of profits as capital, ought to be enjoined because inimical to the best interests of the company and its shareholders, and upon the further claim that in any event the withholding of the special dividend asked for by plaintiffs is arbitrary action of the directors requiring judicial interference.

The rule which will govern courts in deciding these questions is not in dispute. […] This court, in *Hunter v. Roberts, Throp & Co*., recognized the rule in the following language:

> It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders.

In Cook on Corporations (7th Ed.) §545, it is expressed as follows:

> The board of directors declare the dividends, and it is for the directors, and not the stockholders, to determine whether or not a dividend shall be declared. When, therefore, the directors have exercised this discretion and refused to declare a dividend, there will be no interference by the courts with their decision, unless they are guilty of a willful abuse of their discretionary powers, or of bad faith or of a neglect of duty. It requires a very strong case to induce a court of equity to order the directors to declare a dividend, inasmuch as equity has no jurisdiction, unless fraud or a breach of trust is involved. There have been many attempts to sustain such a suit, yet, although the courts do not disclaim jurisdiction, they have quite uniformly refused to interfere. The discretion of the directors will not be interfered with by the courts, unless there has been bad faith, willful neglect, or abuse of discretion. Accordingly, the directors may, in the fair exercise of their discretion, invest

> profits to extend and develop the business, and a reasonable use of the profits to provide additional facilities for the business cannot be objected to or enjoined by the stockholders.

[…] One other statement may be given from *Park v. Grant Locomotive Works*:

> In cases where the power of the directors of a corporation is without limitation, and free from restraint, they are at liberty to exercise a very liberal discretion as to what disposition shall be made of the gains of the business of the corporation. Their power over them is absolute so long as they act in the exercise of their honest judgment. They may reserve of them whatever their judgment approves as necessary or judicious for repairs or improvements, and to meet contingencies, both present and prospective. And their determination in respect of these matters, if made in good faith and for honest ends, though the result may show that it was injudicious, is final, and not subject to judicial revision.

[…] When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had concluded its most prosperous year of business. The demand for its cars at the price of the preceding year continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. […] It had declared no special dividend during the business year except the October 1915, dividend. It had been the practice, under similar circumstances, to declare larger dividends. Considering only these facts, a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required to be done. These facts and others call upon the directors to justify their action, or failure or refusal to act.

In justification, the defendants have offered testimony tending to prove, and which does prove, the following facts: It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving, their quality. As early as in June 1915, a general plan for the expansion of the productive capacity of the concern by a practical duplication of its plant had been talked over by the executive officers and directors and agreed upon; not all of the details having been settled, and no formal action of directors having been taken. The erection of a smelter was considered, and engineering and other data in connection therewith secured. In consequence, it was determined not to reduce the selling price of cars for the year beginning August 1, 1915, but to maintain the price and to accumulate a large surplus to pay for the proposed expansion of plant and equipment, and perhaps to build a plant for smelting ore. It is hoped, by Mr. Ford, that eventually 1,000,000 cars will be annually produced. The contemplated changes will permit the increased output.

The plan […] calls for a reduction in the selling price of the cars. [… T]he plan does not call for and is not intended to produce immediately a more profitable business, but a less profitable one; not only less profitable than formerly, but less profitable than it is admitted it might be made. The apparent immediate effect will be to diminish the value of shares and the returns to shareholders.

It is the contention of plaintiffs that the apparent effect of the plan is […] to continue the corporation henceforth as a semi-eleemosynary institution and not as a business institution. In support of this contention, they point to the attitude and to the expressions of Mr. Henry Ford.

Mr. Henry Ford is the dominant force in the business of the Ford Motor Company. No plan of operations could be adopted unless he consented, and no board of directors can be elected whom he does not favor. […] 'My ambition,' said Mr. Ford, 'is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business.' […]

He had made up his mind in the summer of 1916 that no dividends other than the regular dividends should be paid, 'for the present.'

> 'Q. For how long? Had you fixed in your mind any time in the future, when you were going to pay-- A. No.
>
> 'Q. That was indefinite in the future? A. That was indefinite; yes, sir.'

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken. We have no doubt that certain sentiments, philanthropic and altruistic, creditable to Mr. Ford, had large influence in determining the policy to be pursued by the Ford Motor Company – the policy which has been herein referred to.

[…] There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employees, the number of hours they shall work, the conditions under which labor shall be carried on, and the price for which products shall be offered to the public.

It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, […] it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.

We are not, however, persuaded that we should interfere with the proposed expansion of the business of the Ford Motor Company. [… T]he ultimate results of the larger business cannot be certainly estimated. The judges are not business experts. It is recognized that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture. The experience of the Ford Motor Company is evidence of capable management of its affairs.

It may be noticed, incidentally, that it took from the public the money required for the execution of its plan, and that the very considerable salaries paid to Mr. Ford and to certain executive officers and employees were not diminished. We are not satisfied that the alleged motives of the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders.

It is enough to say, perhaps, that the court of equity is at all times open to complaining shareholders having a just grievance.

[…] Defendants say, and it is true, that a considerable cash balance must be at all times carried by such a concern. But, as has been stated, there was a large daily, weekly, monthly, receipt of cash. The output was practically continuous and was continuously, and within a few days, turned into cash. Moreover, the contemplated expenditures were not to be immediately made. The large sum appropriated for the smelter plant was payable over a considerable period of time. So that, without going further, it would appear that, accepting and approving the plan of the directors, it was their duty to distribute on or near the 1st of August, 1916, a very large sum of money to stockholders.

[The court upholds the lower court's decree that a dividend must be paid, but reverses the lower court's injunction against building the smelting plant.]

Class 2: Shareholders versus Directors (*Blasius Industries, Inc. v. Atlas Corp.*)

Dodge was a philosophical case about an abstract principle: what's the corporation's purpose? In contrast, *Blasius* is a down-to-earth case about the technical details of how shareholders and directors battle over what the corporation does. It is one of my favorite cases in my Mergers & Acquisitions course.

Delaware corporate law strikes a particular balance on the issue of the corporation's purpose: the corporation needs to be operated to maximize shareholders' wealth, but the board of directors is given wide discretion to determine what that interest is.

What can shareholders do when they don't like the board's interpretation of their interests? They can **sell** their shares, but that doesn't directly change the board's behavior (though it could lower directors' compensation if that compensation is tied to the firm's stock price). They can **sue** the directors, but as I said above, Delaware law gives broad discretion for directors to decide what is in the shareholders' interest, as long as there is no evidence that directors are self-dealing (enriching themselves at the shareholders' expense). Finally, shareholders can **vote** to remove and replace the directors, or to increase the size of the board and add more (shareholder-friendly) directors to the board.

Blasius is an excellent case for examining what shareholders can do against directors when they are unhappy with directors' decisions, and also what directors can do to thwart the shareholders. You can think of the case as the first draft of the "Activist shareholder's playbook" as well as the "Directors' manual of defense against activists". To help you understand the case, I need to discuss some nitty-gritty technical details of corporate governance.

Shareholders can act in one of two ways: by calling a **shareholder meeting**, or by **written consent**. A corporation is only required to hold one shareholder meeting per year – the annual shareholder meeting. If shareholders have to wait for the annual meeting, the conflict between them and the directors may already be resolved in the directors' favor (e.g., a third party offer that the shareholders want the firm to accept will have expired; or the board will have time to take actions that make the firm unappealing to the third party). So waiting for the annual meeting is shareholders' last resort.

Additional shareholder meetings (called special shareholder meetings) may be called, but in most Delaware public corporations only the board of directors, not the shareholders, may call special meetings. Naturally, the board won't call a meeting that would allow shareholders to impose their will on the board, so special shareholder meetings are only a viable tool if the corporation's bylaws or charter allow shareholders to call them.

A written consent is a written document that shareholders sign on to. Unless prohibited by the corporation's charter, a written consent is considered the valid act of the shareholders if the appropriate majority of shareholders signed it. The appropriate majority being whatever majority would have been needed to take the same action in a meeting in which all shareholders attended. In the case of replacing a director or changing the corporation's bylaws, this would be a 50% plus one vote). Written consents have another potential advantage over meetings: meetings require advance notification that alerts the directors to the shareholders' plan (which gives time for the board to respond). In contrast, a written consent, if it is kept secret from the board, can be sprung on them as a surprise after the required majority of shareholders signed it, in which case the shareholder action is already a done deal.

For those reasons, the shareholders in *Blasius* chose to act through a written consent.

Once you figure out how to act, the next question is what the action should be. Directors can always be removed for cause (i.e., if they acted in a wrongful way), but they can stall the process by litigating that there was no cause to remove them. Under some circumstances, directors can also be removed by shareholders without cause, but it appears this was not an option in the *Blasius* case.

The shareholders in the Blasius case came up with an original alternative: They planned to increase the size of the board, thereby creating vacancies on the board (spots to which a director has not yet been elected). And they then planned to immediately fill the vacancies with shareholder-friendly new directors. After doing this, the board would still include the original directors, but if shareholders appointed enough new directors, those new directors will have the majority of votes on the board.

The shareholders had to act fast: both shareholders and the board have the power to fill board vacancies, so if the shareholders did not fill the vacancies in the same written consent that created the vacancies (by increasing the board's size), the board would no doubt fill those vacancies immediately (with new directors who support the board's views, not the shareholders' views). Not surprisingly, the shareholders in *Blasius* use the same written consent to both increase the size of the board and to fill the vacancies.

Is there any limit to shareholders' ability to increase the board's size? There might be. The board's size can be determined in the corporation's charter, in its bylaws (as long as they don't contradict the charter), or the charter may delegate to the board to determine its size in a board decision. The charter can only be changed by a joint action of both shareholder and directors, so any limits on board size that are in the charter cannot be changed unilaterally by shareholders. In contrast, bylaws can be changed by unilateral action of either the board or the shareholders, so if the board size was determined in the bylaws, shareholders could change it unilaterally. If the charter had delegated this task to the board, shareholders could do nothing and their plan could not succeed.

In *Blasius*, the charter of the relevant corporation (Atlas) said that the board will be of whatever size the bylaws say it is, but no more than 15 people. The bylaws then stated that the number of directors is 7. So shareholders could unilaterally change board size, but no higher than 15. Unsurprisingly, this is what they tried to do.

But the shareholders lost the element of surprise when word leaked to the board that shareholders were preparing to take over the board by written consent. The board then fought back. I won't spoil the plot for you by telling you what the board did – you'll see when you read the case, below. Suffice to say that it thwarted the shareholders' plan, and the shareholders sued, claiming that the board's actions breached their fiduciary duties.

As I mentioned earlier, directors have a very broad discretion to determine what's in the shareholders' interests, even when shareholders say they want something else. But this is not a typical case; in *Blasius*, shareholders were not giving their opinion on how to run the corporation (which is the board's job and shareholders have no right to dictate); rather, they were using their legal right to act through a written consent, change bylaws and appoint directors to vacancies. In thwarting these actions, aren't directors violating shareholders' rights?

An alternative for the court was to apply the standard it usually applies when directors are self-dealing (e.g., enriching themselves at shareholders' expense). In such cases, the court uses its own judgement as to what's in the shareholders' interests, and does not defer to the directors' views. Courts hate to do this because they do not have the expertise to make business decisions for the corporation. Rather, they use the threat of doing this to deter boards from self-dealing. Expanding the rule to also include situations like *Blasius* would likely force courts to use their own discretion more frequently, a policy that may result in more judicial mistakes that erode the legitimacy the court has.

So what's the court to do? It created a new, in-between, standard of review for situations in which directors thwart shareholders' rights in order to pursue what directors paternalistically believe is in the shareholder's interest. You'll see the details in the case and we will discuss them in class.

I will also discuss in class, at length, one other aspect of this case: it is remarkably modern for a case that's about 30 years old. You could see corporate battles very similar to it in today's newspapers, between activist shareholders (such as some hedge funds) and boards of public corporations. What's remarkable is not just that a case from 1988 seems modern, but that a case from, say, 1978 would not. Delaware law still relies on important precedents from the 1980s (especially the latter half of that decade). Yet hardly any cases from the 1970s, 1960s, or before are still relevant today.

Something happened in corporate America in the 1980s that changed it so dramatically that earlier precedents are mostly irrelevant because they address corporate realities that no longer exist. In contrast, we still live in a corporate world not very different from the one that developed in the 1980s (and therefore precedents from that time are still relevant today). To better understand and enjoy *Blasius*, I will open our class with a brief lesson in economic history that will explain what happened in the 1980s that created a landscape of activist shareholders battling boards of directors – the same landscape that corporate battles are fought over today.

Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651(Del. 1988)

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

The first of the cases was filed on December 30, 1987. As amended, it challenges the validity of board action taken at a telephone meeting of December 31, 1987 that added two new members to

Atlas' seven member board. That action was taken as an immediate response to the delivery to Atlas by Blasius the previous day of a form of stockholder consent that, if joined in by holders of a majority of Atlas' stock, would have increased the board of Atlas from seven to fifteen members and would have elected eight new members nominated by Blasius. […]

[**Factual Background**]

Blasius Acquires a 9% Stake in Atlas.

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

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

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

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

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

The Blasius Proposal of A Leverage Recapitalization Or Sale.

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

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

Immediately following the meeting, the Atlas representatives expressed among themselves an initial reaction that the proposal was infeasible. On December 7, Mr. Lubin sent a letter detailing the proposal. […]

Atlas Asks Its Investment Banker to Study the Proposal.

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

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

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

The Delivery of Blasius' Consent Statement.

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

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

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

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

The conclusion that, in creating two new board positions on December 31 and electing Messrs. Devaney and Winters to fill those positions the board was principally motivated to prevent or delay the shareholders from possibly placing a majority of new members on the board, is critical to my analysis of the central issue posed by the first filed of the two pending cases. If the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, which merely had an incidental impact upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification. The board, as a general matter, is under no fiduciary obligation to suspend its active management of the firm while the consent solicitation process goes forward.

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

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

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

The January 6 Rejection of the Blasius Proposal.

On January 6, the board convened for its scheduled meeting. At that time, it heard a full report from its financial advisor concerning the feasibility of the Blasius restructuring proposal. […]

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

The board then voted to reject the Blasius proposal. […]

[… **Legal Analysis**]

Plaintiff attacks the December 31 board action as a selfishly motivated effort to protect the incumbent board from a perceived threat to its control of Atlas. […] The December 31 action is also said to have been taken in a grossly negligent manner, since it was designed to preclude the recapitalization from being pursued, and the board had no basis at that time to make a prudent determination about the wisdom of that proposal, nor was there any emergency that required it to act in any respect regarding that proposal before putting itself in a position to do so advisedly.

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

One of the principal thrusts of plaintiffs' argument is that, in acting to appoint two additional persons of their own selection, including an officer of the Company, to the board, defendants were motivated not by any view that Atlas' interest (or those of its shareholders) required that action, but rather they were motivated improperly, by selfish concern to maintain their collective control over the Company. That is, plaintiffs say that the evidence shows there was no policy dispute or issue that really motivated this action, but that asserted policy differences were pretexts for entrenchment for selfish reasons. If this were found to be factually true, one would not need to inquire further. The action taken would constitute a breach of duty.

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

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

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

The real question the case presents, to my mind, is whether, in these circumstances, the board, even if it *is* acting with subjective good faith (which will typically, if not always, be a contestable or debatable judicial conclusion), may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. […]

It is established in our law that a board may take certain steps-such as the purchase by the corporation of its own stock-that have the effect of defeating a threatened change in corporate control, when those steps are taken advisedly, in good faith pursuit of a corporate interest, and are reasonable in relation to a threat to legitimate corporate interests posed by the proposed change in control. Does this rule-that the reasonable exercise of good faith and due care generally validates, in equity, the exercise of legal authority even if the act has an entrenchment effect-apply to action designed for the primary purpose of interfering with the effectiveness of a stockholder vote? Our authorities, as well as sound principles, suggest that the central importance of the franchise to the scheme of corporate governance, requires that, in this setting, that rule not be applied and that closer scrutiny be accorded to such transaction.

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

A. *The question of legitimacy.*

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

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

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

The distinctive nature of the shareholder franchise context also appears when the matter is viewed from a less generalized, doctrinal point of view. From this point of view, as well, it appears that the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. That is, a decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance. That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation, but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority. A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation. […]

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

Plaintiff argues for a rule of *per se* invalidity once a plaintiff has established that a board has acted for the primary purpose of thwarting the exercise of a shareholder vote. […]

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

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

In *Aprahamian v. HBO & Company,* the incumbent board had moved the date of the annual meeting on the eve of that meeting when it learned that a dissident stockholder group had or appeared to have in hand proxies representing a majority of the outstanding shares. The court restrained that action and compelled the meeting to occur as noticed, even though the board stated that it had good business reasons to move the meeting date forward, and that that action was recommended by a special committee. […]

[Discussion of the second case was omitted]

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

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

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

I therefore conclude that, even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders. […]