THE BATTLE OVER STOCKHOLDERS VOICE: A CRITIQUE OF AGAR V. JUDY AND THE STANDARD OF REVIEW PROBLEM IN MANIPULATION OF STOCKHOLDERS’ FIRST AMENDMENT RIGHTS

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THE BATTLE OVER STOCKHOLDERS VOICE:

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Yair Y. Even-Tal*

INTRODUCTION

Wars have many fronts. The battle lines in the fight between the director and stockholder control models of the world have evolved dramatically since the early days of the shareholder activism movement. The past few years have seen a remarkable proliferation not only in the amount of stockholder engagements, but also in the sophistication of their attacks on corporations. Specifically, public communication of grievances about intracorporate issues has become a prevalent approach through which the more active stockholders privately police director performance on a real-time basis and seek to influence corporate policy. Objectives for stockholder public engagement vary, but typically include (1) executive compensation

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reforms; (2) capital structure changes; (3) new business strategy; (4) business combinations (e.g., merger, sale, spin off, termination of a transaction); (5) governance initiatives; (6) board representation; and (7) management changes. This once rarely employed model of stockholder engagement, using extra-judicial communication activism to exert pressure on managements to bring leadership and operational changes and asking the target company’s stockholders to rally around them, signaled a marked change in the dynamic of the governance landscape that may become a significant concern for incumbent managements. The response of corporate America was swift. Consistent with the tendency of practitioners to push the limits of the acceptable, boards of directors sought to block both the front (electoral) and back door (negotiated solution) to stockholders’ engagement, using litigation under the guise of purported libel against those stockholders who voiced their opposition.

The libel litigation tactic posed two questions previously unanswered by the Delaware courts, or the judiciary in general. The first question was jurisdictional, in a sense: put colloquially, should boards be authorized to engage in defensive action—even if the action is taken in the absence of actual, subjective improper motive—that potentially adversely affect stockholders’ communication with other stockholders, as well as stockholders voting rights? Second, if so, by what standard of review should the courts evaluate the actions of directors that might impair stockholders franchise and First Amendment rights?

In early 2017, the Delaware Court of Chancery faced these two fundamental questions in the momentous decision of Agar v. Judy,3

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2 Decisions regarding these matters are exclusively within corporate boards’ managerial power. See Del. Code Ann. tit. 8, § 141(a) (“The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors”). Whether stockholders should be permitted to interfere with a firm’s operations and business decision-making has provoked intense debate, but that is for another article.

but did not address the need for balancing the competing policies of stockholders’ corporate-law right to stockholder franchise against the incumbent boards’ tort law rights. Similarly, the Court did not adopt a standard of review in regard to fiduciaries’ inequitable inhibitions of the right to communicate with other stockholders of the company.

In a first treatment by the judiciary about when a fight letter can give rise to a defamation claim, the Judy litigation involved defamation claims brought by incumbent directors of a small-cap company for contentious statements made by a group of dissident stockholders amidst contest for control. Explaining that directors are public figures for electoral-related communication purposes, the Court held that as the party challenging the stockholders’ statements, the directors bore the evidentiary burden of demonstrating that the purported statements were false and made with malice.

While the Judy ruling is significant in that it appears to give stockholders, of privately and publicly-owned corporations alike, broader leeway in exercising their First Amendment rights in regard to intra-corporate communications, the decision did not relieve much of the risk of gamesmanship and concerns about abuse and intimidation by boards of directors. That is, in its decision, the Chancery Court focused only on after-the-fact case-specific review of the director-plaintiffs’ conduct by balancing their tort law right to reputation against the constitutional First Amendment rights of the dissident stockholder group, without addressing the necessity of a normative duty that would ensure good faith conduct and safeguard stockholders’ ability to police inequitable inhibitions before the fact, or, alternatively, an enforceable standard of review to hold fiduciaries accountable if their maneuver results in wrongful interference with stockholders’ free speech and voting rights. This failure to impose a

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5 See id. at 459.
6 I refer interchangeably to forms of discourse between a company's investors and exercising their First Amendment rights as “stockholders' communications”.
7 See id.
further requirement to safeguard stockholders’ right to communicate with other stockholders against, or penalize the incumbent directors for wrongfully suing stockholders for statements that were mere opinion, creates a pervasive incentive for impinging stockholders’ First Amendment rights and highlights the danger of undermining the integrity of the stockholder vote given that such impermissible behavior would not give rise to liability.

In the pages that follow, I argue that these policy concerns emphasize that a stricter approach to regulation of fiduciary conduct involving manipulations of First Amendment rights is warranted given the potential for unfair exploitation of the stockholder electorate. Specifically, this article calls on the courts to engage in a substantive evaluation of actions by directors that effectively cut off stockholders’ exercise of their First Amendment rights using threats of defamation litigation. The heightened form of judicial scrutiny would focus on whether objective circumstances establish that management acted for requisite improper purpose to interfere with the stockholders’ First Amendment rights, without the need of proof of actual, subjective improper motive on the part of the board. This proposed approach would allow the courts to consider the dynamic factors in play and achieve a sensible balance between tort law rights against defamation and ensuring that directors are in fact accountable to stockholders at the ballot box, and do not inequitably interfere with their right to communicate with other stockholders of the company.

Before examining high-salience contexts that reflect the justification for the proposed stricter approach to fiduciary regulation, it is helpful to review the public policy values that warrant imposing the additional safeguards when such potential for abuse emerges.

THE (IN)ESCAPABLE COLLUSION COURSE:
THE TENSION BETWEEN STOCKHOLDERS ENGAGEMENT AND OUR CORPORATE GOVERNANCE SYSTEM

Efforts of those who thrust themselves into a spotlight to quash criticism, fair or unfair, are nothing new. One manner to achieve the desired goal of deterring a targeted section of the public from exercising their constitutional right of free speech is through litigation and its associated rents. The oppressive tactic of initiating
a libel action against those who expressed “disfavored” viewpoints has long been recognized as giving rise to “chilling effects” not only among the individuals at which the threat of litigation has been directed, but also among the targeted audience at large. The tactical approach of bringing defamation litigation with the intent to intimidate and silence had thus posed risks to the societal interests and public policy values that our courts have been vigilant to protect.

This type of gamesmanship gives rise to policy concerns to a greater extent when employed by corporate fiduciaries given their unique relationship and duties owed to their beneficiaries. It is not surprising then that unduly libelous actions brought by incumbent directors to inhibit stockholders’ criticism of management through communication with other stockholders of the company have been attracting a great deal of interest from the media, practitioner and academy.

Investors, unlike other groups of the general public or unaffiliated corporate stakeholders—such as controllers, officers and directors of a company—commit their capital indefinitely to the firm, but yet retain limited mechanisms to effectively and timely monitor managerial conduct and its accompanied ever-present risk of

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9 Often cited corporate accountability devices include: (1) intra-corporate regulation in the form of independence and governance rules that regulate director conduct; (2) intensive surveillance of large institutional shareholders; (3) prominence of “proxy advisory” firms, such as Institutional Shareholder Services; (4) reputation, social, personal, and professional constraints; (5) state corporation law, the concomitant risk of shareholder litigation, and the threat (even if, nevertheless, is still rare) of real personal liability.
disloyal or careless actions. Policing director behavior on a real-time basis, as well as protecting against misappropriation of stockholder wealth and other improper fiduciary interference with stockholders’ rights, are subject to even greater difficulties in privately-held corporations; which are subject only to minimum disclosure regulatory state regimes, thus creating a unique asymmetry information problem. This gap of adequate and oversight mechanisms to ensure managerial corporate accountability that gave rise to the emerging role of exercising the constitutional right of free speech as a potent safeguard against the omnipresent specter of director misconduct. Indeed, entrusted with the exclusive authority to manage the business and affairs of the corporation, equity developed a modern accountability regime backed by fiduciary principles for addressing the acute power asymmetries in relations between managers of the firm and its beneficiaries, the company’s stockholders. Directors’ actions have thus been subjected to pervasive duties of loyalty and care when exercising their broad powers over corporate property and processes. Yet, while legal actions against corporate fiduciaries

\[10\] Malone v. Brincat, 722 A.2d 5, 11 (Del. 1998) (“in the absence of a request for shareholder action, the Delaware General Corporation Law does not require directors to provide shareholders with information concerning finances or affairs of the corporation.”).

\[11\] Del. Code Ann. tit. 8, § 141(a); See McMullin v. Beran, 765 A.2d 910, 916 (Del. 2000) (“One of the fundamental principles of the Delaware General Corporation Law statute is that the business affairs of a corporation are managed by or under the direction of its board of directors.”) (citing Del. Code Ann. tit. 8, § 141(a))); see also Polk v. Good, 507 A.2d 531, 536 (Del. 1986); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981); TW Servs., Inc. v. SWT Acquisition Corp., 1989 WL 20290, at *8 n.14 (Del. Ch. 1989) (“[A] corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation”).

serve as partial, imperfect traditional mechanism to redress unfaithful
conduct and deter improper managerial behavior. These ex-post
judicial reviews are often outweighed by excessive litigation costs
and substantial uncertainty, and thus far from providing investors
adequate protection against fiduciary misconduct. Similarly, other
mechanisms for making those at the helm of the corporate enterprise
accountable for failing to serve the stockholders interests, namely
replacing directors via the ballot box, are rare themselves, due to
hurdles such as multi-class capital structures, costs, limited
access to the ballot, and staggered boards stockholders seeking a
change in the management team must cross.

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13 In re Anderson Clayton S’holder Litig., 1988 WL 97480, at *5
(Del. Ch. 1988) (“[t]he significant institutional role of class and derivative
actions in the enforcement of the fiduciary duties assumed by corporate
officers and directors.”); Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993)
((quoting Aronson, 473 A.2d at 811 (observing that “[t]he machinery of
corporate democracy and the derivative suit are potent tools to redress the
conduct of a torpid and unfaithful management.”)).
14 N. Gantchev, “The Costs of Shareholder Activism: Evidence from a
Sequential Decision Model, 107 J. Fin. Econ. 610 (2013) (finding evidence
that costs associated with dueling consent solicitations average $10.7
million); Hills Stores Company v. Bozic, 769 A.2d 88, 100 (Del. Ch. 2000)
(dismissing challenge by the winning slate in a proxy contest to the payment
of severance upon the change of control to certain executives of the
company).
15 Del. Code Ann., tit. 8, §§ 112, 113 (codifying proxy access rules
for Delaware corporations). These rules authorize corporations to adopt
bylaws that include procedures and conditions to stockholders nominations
in director elections, which may include: (1) minimum stock ownership and
duration of ownership by the nominating stockholder; (2) limitation on the
number of directors that may be nominated; (3) preclusion of nominations by
persons who have acquired a certain percentage of stock ownership, or who
have publicly proposed to acquire such a percentage. See also Financial
stakes and holding periods requirements for publicly-held corporations’
stockholders to put a proposal for a vote); San Antonio Fire & Police
2009), aff’d, 981 A.2d 1173 (Del. 2009) (rejecting a challenge to a change of
control covenant in a bond indenture permitting the noteholders of the
Thus, facing such uphill battles, one of the few viable avenues left for unaffiliated stockholders to police directors’ actions and incentivize them to serve the corporate interest is exercising their constitutional First Amendment rights. Engaging in communication with other stockholders of the company regarding intra-corporate related matters—from management misconduct and outperformance to a mere disagreement with a board’s business decision, serves as a vital function for stockholders to raise their concerns in order to push for an amicable engagement or change by gaining support for a collective stockholder action. Therefore, an attempt by directors to deprive stockholders of the right to voice their critique, under the guise of non-pretextual justification, raises the question of whether, and if so to what degree, similar situationally conflicted fiduciary conducts warrant a hard look by courts.

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Del Code Ann. tit. 8, § 141(d) (expressly permits a certificate of incorporation or bylaw provision that provides for a classified or staggered board).

\[17\]

See generally Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675, 676 (2007) (“Shareholder franchise does not provide the solid foundation for the legitimacy of directorial power that it is supposed to supply.”); Lucian Bebchuk & Oliver Hart, Takeover Bids vs. Proxy Fights in Contests for Corporate Control 2 (Nat'l Bureau of Econ. Research, Working Paper No. 8633, 2001), http://papers.nber.org/papers/w8633.pdf. (‘...even when a rival team would be better at leading the firm, convincing fellow stockholders that this is the case would likely require significant efforts with no guarantee of success. Stockholders would be making their choices under conditions of uncertainty: to vote for the rival team, they must be convinced not only that the incumbents’ performance is sub-par, but also that the rival team would likely perform better. Otherwise, stockholders might well choose to stay with the devil they know.’); see also Transcript of Motion to Expedite Ruling, Flagship Master Fund, LP v. Rent-A-Center, Inc., et al., C.A. No. 2017-0165 (Del. Ch. Mar. 10, 2017) (challenge to company’s bylaws requiring stockholders’ director nominees to be included in the target's proxy statement).
AGAR V. JUDY: THE DIFFICULTIES OF RECONCILING THE RIGHT TO INTRA-CORPORATE COMMUNICATION WITH FIDUCIARIES’ RIGHT AGAINST DEFAMATION

This long ignored knotty issue of whether managerial actions brought with the goal to muffle stockholders’ voice—particularly during an active proxy contest with defeat of plaintiff directors looming, warrant judicial intervention—had not been addressed by the courts, neither in Delaware nor elsewhere, until a recent measured yet important step has been made to establish rules of the road in the case of Agar v. Judy. In a first treatment by a Delaware court about when contentious stockholder engagement in the form of a fight letter can give rise to a defamation claim, the Court of Chancery fashioned an approach to balance the competing interests of stockholders’ constitutional First Amendment rights of communication and directors’ tort law rights against defamation. Although the Court’s treatment of this matter of first impression resulted in a largely fact-intensive ruling, as is often the case in defamation cases, it encompasses important ramifications for repeat players in the Chancery Theater, as well as for many observers of corporate governance outside circles of Rodney Square.

The conflict in Judy stemmed from a poorly performing company’s 2015 stockholders meeting, at which a group of unaffiliated stockholders opposed the reelection of the incumbent directors following many years of corporate functions that had not been carried out and alleged directorial misconducts occurred. In advance of the annual meeting, at which three of the incumbent directors eventually lost their seat, the dissident group signed a letter which they distributed to a large number of the company's stockholders.

18 Judy, 151 A.3d 456.
19 Id. at 479.
20 Id.
The circulated letter included a series of statements that accused the company directors of acting to benefit themselves by engaging in self-dealing, wasteful, and unapproved transactions. In addition to the allegation of corporate resources misuse, the letter informed its recipients that the incumbents have concealed from the stockholders the existence of court orders entered against the company in lawsuits brought by its stockholders and noteholders, as well as that it has

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21 The series of statements included the following accusations towards the incumbents: (1) “[T]hey were planning to loot [the Company] without any oversight on your part until it was too late.”; (2) “Due to our lawsuits, we have received documents that show in particular [incumbents] have engaged in looting the Company. Since June of 2014, [the incumbent directors] have siphoned over $7 million in cash and stock to themselves and personal affiliates.”; (3) “Carole Downs is now the leader ... and is in the process of looting the Company along with Barclay Knapp.”; (4) “[the incumbents] siphoned over $7 million in cash and stock to themselves and personal affiliates.”; (5) “It is in [the incumbent directors’] personal interest to drag this out and siphon your money out at their leisure. [the incumbent board] owe you their fiduciary duty to protect the Company assets but instead they are favoring these other affiliates and themselves.”; and (6) “It is time to act and stop them from taking your money. We must remove them from their positions before it is too late.”

22 The “concealment statements” included the following: (1) “[The incumbent directors are] so afraid of you finding out what they are up to that one of the first things they did when they took over was to take away your right to call for a shareholder meeting by eliminating that provision in the Company Bylaws (They even tried to hide this from us until the Court forced them to send us the amended Bylaws).”; (2) “After an intense battle that lasted into December of 2014, the Company was forced kicking and screaming to settle. This loss shocked them to change their plans and forced them to make payment on all the notes.”; (3) “Have they disclosed to you that the Court has a restraining order prohibiting them from distributing any funds to preferred and common stock holders until the lawsuit in Delaware resolves the complaints?”; (4) “Did they disclose that the Court admonished them that they had to pay the accrued dividends and liquidation preference on preferred stock in liquidation?”; (5) “Did they disclose to you that they were forced by the Court to hold a shareholder meeting on June 22, 2015 (the
breached contractual obligations to preferred stockholders. The letter concluded by urging the stockholders to replace the incumbent board. The removed directors then brought a claim for defamation. The dissidents moved to dismiss.

The Court of Chancery granted the dissidents' motion to dismiss in part, holding that corporate directors may be public figures for purposes of electoral-related communications. Thus, exercise of the First Amendment right to free speech on intra-corporate issues by stockholders would not give rise to liability absent a showing—in addition to all other necessary elements of a defamation claim—that the statements made were false and made with actual malice.

The rationale for holding corporate directors as public figures under the tort and constitutional law standards, the Judy Court explained, was two-fold. First, nominees who run for and take corporate office as directors, voluntarily expose themselves to attention and comment on their actions by stockholders, who monitor their performance. The second rationale for recognizing fiduciaries

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23 Id. at 468. (1) “[The incumbents] were not going to pay what was owed on the notes. They were not going to pay the accrued dividends on preferred stock. They were not going to pay liquidation preference to outstanding preferred stock. They were not going to pay anything on the GX License claims. They reduced stock owned by individuals that had been approved by the Court.”; (2) “Thanks to those plaintiffs your notes were paid and not because the Company wanted to, and that is the truth.”; (3) “Soon, that $60 million [in cash the Company received from a transaction] will be down to less than $5 million and [the incumbent directors are] threatening to renege on their promise to you to liquidate and make a distribution to stockholders.”).

24 Id. at 467-68.

25 Id. at 477.

26 Id. at 479 (explaining that the voluntary choice of corporate candidates to thrust themselves in the forefront and endure publicity when seeking to be elected to lead corporations was a key justification in viewing them as a public figure for the electoral-related communications purposes).
as public figures, the Court observed, is that access to corporate funds that directors can deploy to communicate with investors by multiple means, enables them to counter criticism and expose fallacies.\(^{27}\)

In considering whether the director-plaintiffs were deemed public figures, the Court found that by seeking reelection after prevailing at a hotly-contested proxy contest in the last elections held in 2013, the director-plaintiffs voluntarily assumed the risk of injury from defamatory falsehood and therefore were deemed public figures.\(^{28}\) Elaborating on its reasoning, the Court noted that the incumbent director’s knowledge that the dissident group continuously opposed them, and that both the dissidents and the other stockholders had monitored their actions, served as further evidence that the removed directors exposed themselves to the risk of closer scrutiny.\(^{29}\) The Court then went further and emphasized the importance of the incumbents’ greater access to channels of effective communication, namely the ability to utilize internal corporate information to respond to the allegations of misconduct by instructing the Company’s employees to develop rebuttals to the dissidents’ contentions as well as the board’s control of the content of the circulated proxy materials, in supporting the conclusion that the director-plaintiffs were public figures within the community of the Company’s stockholders.\(^{30}\)

With those overarching considerations in mind, the Court turned to assess whether the statements made in the fight letter were defamatory. Starting its examination by considering the statements of the wrongful wealth transfer, the Court determined that given that the investors knew that the parties were staunch adversaries engaged in a lengthy duel over the control of the Company, the investors would consider those statements as a constitutionally protected

\(^{27}\) Id. at 480.

\(^{28}\) Id. at 479.

\(^{29}\) Id. at 479-80.

\(^{30}\) Id. at 480.
expression of opinion, rather than statement of fact. In further support of its holding, the Court explained that “proxy fight letters are pitches for a cause, and tend towards emphatic language in order to sway shareholders to the dissident's side,” which therefore made it “highly unlikely that the company's stockholders would view the Looting Allegations as alleging criminal conduct.” Hence, the Court concluded, the looting statements were constitutionally protected opinion under the First Amendment and therefore not actionable.

Next, the Court turned to assess whether the concealment allegations could give rise to liability as libelous. Finding that the incumbent directors failed to meet their burden of proof and establish that the statements made in connection with judicial orders—which were entered against them in multiple actions—were not substantially true, the Court concluded that the concealment allegations were nonactionable as defamatory.

The Court then turned to the removed director’s final challenge—the payment allegations that included accusations that the incumbents planned to cause the Company to breach its contractual obligations and prolong distributions to its investors by engaging in a related-party transaction. Failing to proffer any evidence that supported their assertions, the Court held, that at the pleadings stage, it was reasonably conceivable that these statements were known by dissident group to be false or alternatively made with reckless disregard of the truth. Therefore, the Court granted the motion to dismiss as to payment allegations.

The Court of Chancery’s Judy decision is undoubtedly a game changer for stockholders in a couple of respects. First, called to the


31 Id. at 484-85.
32 Id. at 484 (quoting Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations § 12.8 (3d ed. 2015)).
33 Id. at 486-87.
34 Id.
task of balancing the competing policies of stockholders’ constitutional right to free speech and fiduciaries’ tort law rights to reputation, the Court acknowledged for the first time the need for protection of the right to communicate with other investors of the company. Presented with this novel and seemingly irreconcilable clash, the Court defined the scope of stockholders’ First Amendment rights to free speech in intracorporate contexts by requiring that aggrieved incumbent fiduciaries who bring defamation claims for such communications, bear the evidentiary burden of demonstrating that the statements were false and made with malice. Thus, imposing heightened constitutional pleading requirements for establishing liability for defamation, the Court in Judy provided all stockholders, whether of a privately or publicly-owned company, broader protection against wrongful managerial interference with the exercise of their free speech and voting rights.

Second, the Judy decision presumably extends beyond proxy contest fight letters to different stockholders engagements, such as activist stockholders’ “poison pen” letters.

The Vice-Chancellor’s ruling in Judy, however, raises corporate law policy concerns. The decision seems to overlook that the incumbents of the Company in Judy wrongfully sued, using corporate funds, the proponent stockholders about statements that were mere opinion. Failing to condemn and impose sanctions on fiduciaries for engaging in an impermissible action creates a pervasive incentive for fiduciaries to continue in their attempt to block stockholders from meaningfully and effectively monitor their behavior, further isolating themselves from accountability, as well as exercising their core rights to free speech and voting.

Most problematically, however, is the Court’s focus on the director-plaintiffs’ challenges to the critique against them in isolation, rather than establishing normative duty to safeguard against managerial interference with stockholders’ free speech and voting rights. Put differently, merely balancing the antagonist parties’ interests to reputation on the one hand and free speech on the other, without determining whether fiduciary interference with these rights meet equitable standard of conduct of corporate directors, leads to concerns about opportunism, imposition of unnecessary costs on stockholders and overall wealth creation. Alternatively, the Court had not seized the opportunity to determine whether board
interference with stockholders’ right of intra-corporate communication should trigger corporate law standard of review.

To illustrate the need of establishing a standard of review under which director liability will be judged in circumstances of potential manipulation of the stockholders franchise, consider the following examples. A publicly-traded company engaged in the production and sale of rare earth minerals has recently completed an initial public offering. Despite the capital raising, the company struggles financially due to underestimation of significant costs necessary to modernize and expand its facilities, as well as a spike in prices of rare earth minerals, which are subject to boom-bust pricing cycles. Shortly after the IPO, certain preferred stockholders who hold registration rights demanded registration of their shares, which they eventually sold in a significant profit. During the same timeframe, the company lagged behind its capital budget. Management also learned that an anticipated loan guarantee would not come through, jeopardizing a joint venture opportunity. The company’s preferred stockholders again demanded registration of their shares, which they sold in a profit. At the time of both the private offerings, the company board consisted of eight members, seven of whom either sold stock or were affiliated with the preferred stockholders who sold stock in offerings. A couple of months later, prices of rare earth minerals dropped. Significantly lagging behind its capital budget, the company raised debt through a private note offering as well as capital through stock sales at a deep discount compared to sale prices at which the preferred stockholders sold their shares.

In the lack of standard of conduct and standard of review to check potential abuse of power in situations of directorial actions impinging stockholders’ right to speech—such as the filing of the defamation suit—minority stockholders would be discouraged to monitor managerial actions that may be viewed as interested, suboptimal to the corporation, as illustrated by the example above. The absence of a judicial review standard of such unleashed managerial actions, gives rise to the policy concern of disproportionate incentives of boards of directors to take interested actions to wrongfully interfere with the exercise of the constitutional right to speech without being held accountable. That is, the current regime where stockholders can be held liable for libel by mere after-the-fact showing that they exercised their First Amendment rights on incomplete information and thus acted with reckless disregard, while fiduciaries are not accountable for acting on the expense of the cestui
que trust that they are supposed to serve, dwarfs stockholders’ incentives of real-time management monitoring.

This risk of erecting unreasonable barriers to stockholder monitoring solidifies given that stockholders’ communication with other investors of the company is virtually always made with less than perfect information. Despite federal and Delaware corporate law system’s effort to drive fuller disclosure of key information like financial projections relevant to transactional votes, material conflicts of interest, and the process used to reach decisions, no

35 See, e.g., In re Pure Res., Inc., Shareholders Litig., 808 A.2d 421, 450 (Del. Ch. 2002) (“When controlling stockholders make tender offers, they have large informational advantages that can only be imperfectly overcome by the special committee process, which almost invariably involves directors who are not involved in the day-to-day management of the subsidiary. The retention of financial advisors by special committees is designed to offset some of this asymmetry, and it would seem to be in full keeping with that goal for the minority stockholders to be given a summary of the core analyses of these advisors in circumstances in which the stockholders must protect themselves in the voting or tender process. That this can be done without great burden is demonstrated by the many transactions in which meaningful summary disclosure of bankers’ opinions are made, either by choice or by SEC rule.”).

36 See, e.g., In re El Paso Corp. S’holder Litig., 41 A.3d 432, 434 (Del. Ch. 2012) (“The record is filled with debatable negotiating and tactical choices made by El Paso fiduciaries and advisors. Absent a conflict of interest, these debatable choices could be seen as the sort of reasonable . . . ones that must be made in a world of uncertainty. After discovery, however, these choices now must be viewed more skeptically, as the key negotiator on behalf of the Board and a powerfully influential financial advisor each had undisclosed] financial motives adverse to the best interests of El Paso’s stockholders.”).

37 See, e.g., In re Netsmart Techs., Inc. Shareholders Litig., 924 A.2d 171, 177, 209 (Del. Ch. 2007), judgment entered sub nom. In re Netsmart Technologies, Inc. Shareholders Litigation (Del. Ch. 2007) (“The record, as it currently stands, manifests no reasonable, factual basis for the board’s conclusion that strategic buyers in 2006 would not have been interested in Netsmart as it existed at that time. . . . [It seems] important for Netsmart to at least disclose this judicial decision or otherwise provide a fuller, more
other area of the law presents an “information asymmetry” problem as significant as the corporate governance landscape. The reason for the grave asymmetry problem is encompassed in the fact that information is solely within management’s control. Even the statutory mechanism of inspecting corporate books and records does not level the playing field, mainly because stockholders who seek to obtain access to corporate records are required to establish that an alleged wrongdoing, which is the very subject of the investigation sought, occurred and overcome merits defenses without access to the underlying facts. Thus, stockholders often fail to satisfy this requirement because the reason the very claims for books and records are based on what a stockholder seeks to investigate.

Another set of situations where subjecting management’s interference with stockholders’ constitutional intracorporate balanced description of the board’s actions with regard to the possibility of finding a strategic buyer. As the Proxy now stands, its description of that issue leads one to the impression that a more reasoned and thorough decision-making process had been used, and that the process was heavily influenced by earlier searches for a strategic buyer that provided a reliable basis for concluding that no strategic buyer interest existed in 2006.”).

38 The right of stockholders to demand inspection of books and records is by nature conditional, subjected to statutorily, judicial, and corporate-imposed, restrictions that limit stockholders access to intra-corporate information. See 8 Del. C. § 220; Nw. Indus., Inc. v. B.F. Goodrich Co., 260 A.2d 428 (Del. 1968) (denying stockholder’s demand for inspection stated as its purpose “to communicate with the other stockholders of your company with reference to a special meeting of the stockholders.”). Even legal vehicles for obtaining information about the corporation, such as where a stockholder sues to compel inspection if her demand is refused or not answered by initiating a section 220 action, which contemplates summary and expedited proceedings that emphasizes prompt processing and disposition, to investigate purported improper transactions, inquire into management inadequacies, or for communication-related purposes, often defeat stockholder urgent, time sensitive need to address a rising corporate wrongdoing on a real-time basis. Scott v. Boca Bancorp, C.A. No. 22649, slip op. at 1 (Del. Ch. 1990) (stating that expedited treatment not automatic unless only stock list sought).
communication right to an appropriate standard of review arises in circumstances where directors’ decisions are on the specter of suspicious, yet permissible actions.

Take, for example, a saving and loan publicly-held company whose board of directors has recently approved a number of amendments to the bylaws due to media publications that a notorious investment fund firm has considered to increase its stake in the Company due to its recent disappointing performance. The first amendment increased the threshold for nominating candidates to the board from 10% to 30%. The second requiring 80% supermajority voting requirement to amend the bylaws and provisions related to the size of the board. The third reducing the size of the Company’s staggered board from seven to five, which results in one seat—rather than three—coming up for election at the current year’s annual meeting.

Given the apparent bona fide actions of the board, which was not faced with a proxy contest or an expected proxy contest when it acted, the lack of a standard of review of fiduciary actions that have the effect of hindering the exercise of stockholders’ intra-corporate communication rights—such as pretextual defamation claim—effectively forecloses stockholders’ remaining oversight tool at hand.

Thus, the increasing importance of real-time monitoring of corporate actions further emphasizes the need of establishing an accountability mechanism against wrongful interference with stockholders’ constitutional communication rights. Any efforts by fiduciaries to wrongfully interfere with stockholders’ intracorporate right to speech, even where there is no clear conflict of interest between the directors and the stockholders, must bestir deep judicial suspicion to ensure that the legitimacy of the corporate structure itself is not undermined. Or stated bluntly, Judy emphasizes the need of formulating doctrinal principles outside the realm of the First Amendment sphere, to provide strong-form protection where director consciously choose to improperly interfere with stockholders’ right to free speech and voting.
SEARCHING FOR THE OPTIMAL BALANCE BETWEEN STOCKHOLDERS’ COMMUNICATION RIGHTS AND CORPORATE LAW PUBLIC POLICY

Stockholders’ right to elect directors is in the first instance statutory. Corporate law statutes, in an effort to achieve accountability of corporate fiduciaries, however imprecisely, requires that an annual meeting of stockholders be held for the election of directors.39

Occasionally, boards act in a manner—though not specifically prohibited by the statute nor inherently nefarious—that may have the effect of interfering with or impeding the effective exercise of corporate democracy by stockholders, especially when a contest of control is in the background. Keeping with the traditional vigilance of ensuring the fairness of the process by which directors are elected, courts have approached such directorial interventions that affect the stockholder franchise with a “gimlet eye,”40 irrespective of technical compliance with the corporation law statute.41

39 E.g., Del Code Ann. tit. 8, § 211(b)-(c).
40 E.g., MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1127 (Del. 2003) (“This Court and the Court of Chancery have remained assiduous in carefully reviewing any board actions designed to interfere with or impede the effective exercise of corporate democracy by shareholders, especially in an election of directors.”); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (finding that “utiliz[ing] the corporate machinery and the Delaware Law for the purpose of perpetuating [management] in office; and, to that end, for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management” are “inequitable purposes, contrary to established principles of corporate democracy”); State of Wisconsin Inv. Bd. v. Peerless Sys. Corp., 2000 WL 1805376, at *7 (Del. Ch. 2000) (holding that although the primary purpose of an adjournment was to “ensure the passage of” the proposal by “interfering with the shareholder vote,” the board could prove a compelling justification for the adjournment); Chesapeake Corp. v. Shore, 771 A.2d 293, 297 (Del. Ch. 2000) (enjoining, under Blasius, the board’s decision, after learning of a dissident’s plan to amend the company’s bylaws and declassify the board, to preemptively amend the bylaws to eliminate the
To deal with the complexity of director actions that improperly interfere with a vote touching upon matters of corporate control, the Delaware courts—in a classic manifestation of the concept of separation of powers—have placed the burden of persuasion on ability of shareholders to remove directors without cause, eliminate shareholders’ ability to fill vacancies on the board, and most importantly to require a supermajority shareholder vote to amend the bylaws in the future); Agranoff v. Miller, 1999 WL 219650, at *11-12, *18 (Del. Ch. 1999); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988); Lerman v. Diagnostic Data, Inc., 421 A.2d 906, 914 (Del. Ch. 1980) (invalidating board’s action setting an annual meeting that made it impossible to comply with an advance notice bylaws requirement after learning about insurgent's intention to wage a proxy fight).

Schnell, 285 A.2d 437, 439 (Del. 1971) (holding that “inequitable action does not become permissible simply because it is legally possible”); Marino v. Patriot Rail Co., 131 A.3d 325, 336 (Del. Ch. 2016) (“Post-1967 decisions by the Delaware Supreme Court . . . rendered untenable the strong-form contention that a statutory grant of authority necessarily foreclosed fiduciary review.”); see also Adolphe A. Berle, Corporate Powers As Powers In Trust, 44 HARV. L. REV. 1049, 1049 (1931) (“[I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a cestui que trust to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary.”); Sample v. Morgan, 914 A.2d 647, 672 (Del. Ch. 2007) (Strine, V.C.) (“Corporate acts thus must be ‘twice-tested’ – once by the law and again in equity.”); accord Quadrant Structured Prods. Co. v. Vertin, 2014 WL 5465535, at *3 (Del. Ch. Oct. 28, 2014) (“Delaware law adheres to the twice-testing principle.”), aff’d, 151 A.3d 447 (Del. 2016) (TABLE); Carsanaro v. Bloodhound Tech., Inc., 65 A.3d 618, 641 (Del. Ch. 2013) (“Corporate acts are twice-tested, once for statutory compliance and again in equity.”); see also In re Pure Res., Inc. S’holders Litig., 808 A.2d 421, 434 (Del. Ch. 2002) (Strine, V.C.) (“Nothing about [the doctrine of independent legal significance] alters the fundamental rule that inequitable actions in technical conformity with statutory law can be restrained by equity.”).
boards to justify their actions in order to strictly police inequitable inhibitions of the stockholder franchise.\textsuperscript{42}

\textsuperscript{42} \textit{In re Trados Inc. S’holder Litig.}, 73 A.3d 17, 43 (Del. Ch. 2013) (explaining that enhanced scrutiny applies to specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors. Inherent in those situations are subtle structural and situational conflicts that do not rise to a level sufficient to trigger entire fairness review, but also do not comfortably permit expansive judicial deference. In those contexts, “the predicate question of what the board’s true motivation was comes into play,” and “[t]he court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board.”); see \textit{Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.}, 506 A.2d 173, 176, 180–82 (Del. 1986) (applying Unocal test to the sale of a corporation in light of concern that the directors rebuffed a premium acquisition offer and agreed to a white knight transaction, because (1) the target CEO felt a “strong personal antipathy” towards the acquirer, and (2) the directors feared potential litigation by noteholders); \textit{Unocal Corp. v. Mesa Petroleum Co.}, 493 A.2d 946, 954 (Del. 1985) (creating enhanced scrutiny to address the “omnipresent specter” that when resisting a hostile takeover, target directors may be influenced by and act to further their own interests or those of incumbent management, “rather than those of the corporation and its shareholders”); see also \textit{In re El Paso Corp. S’holder Litig.}, 41 A.3d 432, 439 (Del. Ch. 2012) (“[T]he potential sale of a corporation has enormous implications for corporate managers and advisors, and a range of human motivations, including but by no means limited to greed, can inspire fiduciaries and their advisors to be less than faithful . . . .”); \textit{MM Cos., Inc. v. Liquid Audio, Inc.}, 813 A.2d 1118, 1129 (Del. 2003) (extending the rubric of enhanced scrutiny to incorporate the principles that animated Chancellor Allen’s decision in \textit{Blasius} and directed that they be applied “within the . . . enhanced standard of judicial review.”); \textit{Mercier v. Inter-Tel (Del.), Inc.}, 929 A.2d 786, 811 (Del. Ch. 2007); see also \textit{Stroud v. Grace}, 606 A.2d 75, 92 n.3 (Del. 1992) (holding that enhanced scrutiny applies whenever a board takes unilateral action “touch[ing] upon issues of control”) (quotation marks omitted); \textit{Gilbert v. El Paso Corp.}, 575 A.2d 1131, 1144 (Del. 1990) (holding that a court must apply enhanced scrutiny whenever the board acts “in response to some threat to corporate policy and effectiveness which touches upon issues of control”); see also Gregory V. Varallo et al., \textit{From Kahn to Carlton: Recent Developments in Special Committee Practice}, 53
Thus, consistent with the central tradition of Delaware corporate law, a board’s conduct that supports an inference of a conscious, self-interested action on part of the fiduciaries to improperly interfere with stockholders’ right to intra-corporate communication have sufficient disenfranchising effect to trigger Mercier v. Inter-Tel and Pell v. Kill enhanced judicial scrutiny.

BUS. LAW. 397, 423 n.121 (1998) (explaining that the two-step Zapata test is “reminiscent of the enhanced scrutiny courts use to examine the actions of directors engaged in a sale of a corporation or other like transactions”); Julian Velasco, Structural Bias and the Need for Substantive Review, 82 WASH. U. L.Q. 821, 851 (2004) (discussing standard and concluding that “Zapata is thus quite similar to Unocal”); Paramount Comme’ns Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1993) (“[T]here are rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors. In these situations, a court subjects the directors’ conduct to enhanced scrutiny to ensure that it is reasonable.”); In re Dollar Thrifty S’holder Litig., 14 A.3d 573, 597 (Del. Ch. 2010) (“Avoiding a crude bifurcation of the world into two starkly divergent categories—business judgment rule review reflecting a policy of maximal deference to disinterested board decision-making and entire fairness review reflecting a policy of extreme skepticism toward self-dealing decisions—the Delaware Supreme Court’s Unocal and Revlon decisions adopted a middle ground.”).

43 Id. See Mercier, 929 A.2d at 818 (“In prior decisions, this court has decided that because board action influencing the election process did not have the effect of precluding or coercing stockholder choice, that action was not taken for the primary purpose of disenfranchising stockholders. Because non-preclusive, non-coercive action did not have the primary purpose of disenfranchisement, the Blasius standard did not apply and thus no compelling justification for the board's action had to be shown. That is, the lack of disenfranchising effect provided that the trigger for the test was not pulled.”).

44 Judy, 135 A.3d 764 (Del. Ch. 2016) (enjoining plan to reduce size of board that would maintain certain defendant directors in the majority and would neutralize the threat of a pending proxy contest, explaining that “when facing an electoral contest, incumbent directors are not entitled to determine the outcome for the stockholders. Stockholders elect directors, not the other way around. Even assuming that the Defendant Directors acts for an
By nature, directors cannot be expected to remain neutral with respect to matters of corporate control. This omnipresent, inherent conflict of interest when a board, even if independent and otherwise disinterested, justifies subjecting fiduciary interference with the stockholders’ intracorporate communication rights to a heightened judicial review, even if the board’s tactics, however subtle, do not have the effect of outright impairing the franchise. In particular, such robust judicial review requires inquiry into the context—history, timing, and content—of the board’s action that interferes with stockholders’ right of intracorporate communication.

Invoking an intrusive standard of review to a board’s heavy-handed tactic to erect barriers in the path of dissident stockholders’ right to speech, especially in the context of a contest for corporate control, is also justified for the reason that the real parties in interest—the minority equity owners—often cannot protect themselves at the ballot box by simply replacing the board. Furthermore, although establishing that a statement was defamatory and made with scienter is a tall order, it is the threat of a retributive

unselfish purpose, they still acted inequitably.”); see also Aquila, Inc. v. Quanta Servs., Inc., 805 A.2d 196, 205 (Del. Ch. 2002) (corporation’s creation of an employee benefit trust to hold newly issued stock, thereby measurably diluting the holdings of a significant stockholder engaged in a proxy contest, was “neither preclusive no coercive” and thus would be considered under Unocal).

45 Mercier, 929 A.2d at 810-11 (explaining that enhanced scrutiny review applies to director action that affects stockholder voting requires the board to prove that (1) its motivations were proper and not selfish, (2) it did not preclude stockholders from exercising their right to vote or coerce them into voting a particular way, and (3) the board’s actions were reasonable in relation to its legitimate objective. If the fit between means and end is not reasonable, then the board falls short.).

46 Aprahamian v. HBO & Co., 531 A.2d 1204, 1206 (Del.Ch.1987) (“A candidate for office, whether as an elected official or as a director of a corporation, is likely to prefer to be elected rather than defeated. He therefore has a personal interest in the outcome of the election even if the interest is not financial and he seeks to serve from the best of motives.”).
action motivated by the incumbent directors’ self-interest to hinder stockholder intracorporate communication rights by miring the vocal dissident that supports the utility of judicial-intrusive standard of review.

Subjecting a board’s action that has the effect of stymieing stockholders’ right to speech would thus go a long way to provide a strong medicine against impermissible interference with stockholders franchise.

Employing the enhanced scrutiny test to the director-plaintiff’s defamation suit in Judy, as an example, would have likely resulted in findings that the electoral process has been tainted by inequitable behavior of the removed directors. Indeed, the director-plaintiff’s action to interfere with the dissident group’s First Amendment communication rights with other stockholders of the company was not a blatant and obvious attempt to interfere with the stockholder franchise or otherwise undermined the stockholders’ right to act directly, but rather a subtle one. Subtlety, however, does not take conduct beyond the realm of equity. The backdrop of the dysfunctional state of affairs of the company under the incumbent board's management and the animosity between the factions, support the inference that the director-plaintiff’s defamation suit was pretextual, designed to thwart the dissident stockholders’ opposition and perpetuate them, and was not tailored to adequately justify their wrongful interference with the company stockholders’ exercise of their constitutional speech rights.

CONCLUSION: DIRECTOR INTERFERENCE WITH STOCKHOLDERS’ INTRA-CORPORATE COMMUNICATION RIGHTS MUST REFLECT THE POLICY VALUES EMBODIED IN THE ENHANCED SCRUTINY STANDARD

The preceding discussion highlights the distortion of incentives that can arise when an appropriate standard of review is not applied in situations of wrongful managerial interference with the right of intra-corporate stockholder communication. In the corporate community, employing the level of behavior that will subject a corporate director to liability is a highly sensitive and important matter. When courts do not carefully inquire into whether legal conduct affecting stockholders’ intracorporate communication rights
may nonetheless be situationally inequitable, they affect director behavior in ways that are unintended and undesirable.

*Judy* illustrates this proposition, leaving open to directors to purposely impinge on the almost sacred right to elect a new board—an area of fundamental importance to stockholders. To align judicial decision-making with the traditional public policy values of fiduciary conduct, courts should reassess this decision, and adopt a strict doctrinal standard to review actions by corporate fiduciaries that affect the right to intra-corporate communication, and as a result stockholders’ franchise. That approach would: (1) send a clear message to boards and their advisors that they must be very careful when taking an action that may have the effect of unconstitutionally disenfranchising the electorate in violation of stockholders’ First Amendment’s right to intra-corporate communication—in other words, applying the enhanced standard of review would leave it open to boards to exercise their broad authority to manage the affairs of the corporation as well as protect their right to reputation, so long as they are prepared to justify, in a situationally specific way, their behavior; and (2) better balance the competing interests of corporate directors’ and officers’ tort law right to reputation and stockholders’ First Amendment right to communicate with other investors of the corporation.