

CLIENT ALERT: Delaware Chancery Court Affirms Fundamental Right of Shareholders to Remove Annually Elected Directors By Majority Vote Despite Supermajority Voting Threshold in Bylaws

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We are often asked by our activist clients whether the organizational documents of a corporation and applicable state law allow shareholders to remove directors with or without cause and whether a majority or supermajority vote is required to effect such removal. These are important questions to ask when evaluating a potential target's defense profile.

Demonstrating cause, if required to remove directors, is next to impossible absent a clear showing of illegal or wrongful conduct. Similarly, depending on the concentration of the shareholder base, it may be impractical to obtain an affirmative supermajority vote – such as 66 2/3% or 80% of the outstanding voting power – if required to remove directors.

In Delaware, where many corporations are incorporated, shareholders have the right to remove annually elected directors without cause by a majority vote of the outstanding shares. Specifically, Section 141(k) of the Delaware General Corporation Law (“Section 141(k)”) provides that “any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors,” subject to exceptions that only apply to corporations with classified boards or cumulative voting. As a result, shareholders of Delaware corporations are capable of exerting some degree of pressure on annually elected boards with their ability to seek to remove directors, without the need to show cause, especially if they are also permitted to call special meetings or take action by written consent for such purpose.

In a recent class-action lawsuit filed in the Court of Chancery of Delaware against Nutrisystem, Inc. (“Nutrisystem”) and members of its board of directors captioned *Frechter v. Zier (Nutrisystem, Inc.), et al.*, Vice Chancellor Sam

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Glasscock III affirmed that shareholders of a Delaware corporation have a fundamental right to remove annually elected directors without cause by a vote of a majority of the outstanding shares entitled to vote in the election of directors despite having bylaw provisions to the contrary requiring a supermajority vote. In *Frechter*, the Plaintiff alleged that a provision in an amendment to Nutrisystem's bylaws that purported to enable shareholders to remove directors only by the vote of not less than 66 2/3% of the voting power of all outstanding shares was inconsistent with the majority voting threshold for the removal of directors under Section 141(k). Prior to this amendment, Nutrisystem's bylaws permitted shareholders to remove directors only for cause and by a vote of 66 2/3% of the outstanding shares. The more recent amendment in question eliminated the "for cause" requirement, which the Court previously held in *In re VAALCO Energy, Inc. Stockholder Litigation* was unlawful under Section 141(k), but retained the supermajority voting requirement. The Plaintiff alleged that the Nutrisystem directors "breached the duty of loyalty by enacting an unlawful bylaw to entrench themselves in office" and sought a declaratory judgment that the bylaw provision violated Section 141(k).

The Court agreed with the Plaintiff's argument that, based on a plain reading of Section 141(k), Nutrisystem's supermajority voting requirement was inconsistent with the unambiguous majority vote threshold required to remove directors under the statute. The Court rejected the Defendants' contention that the permissive language of Section 141(k) through the use of the phrase "may be removed" allows the board of a Delaware corporation to select any voting threshold for the removal of directors in its bylaws. Vice Chancellor Glasscock stated, "Defendants' construction of Section 141(k), that a majority may – but only if the corporation's bylaws so permit – remove directors, renders the 'majority' provision essentially meaningless, and leaves the statutory provision an effective nullity." Accordingly, the Court held that the supermajority voting provision contained in Nutrisystem's bylaws was unlawful.

During the course of our review of potential targets for our activist clients, we have seen similar Delaware bylaw provisions that purport to allow shareholders to remove annually elected directors only by a supermajority vote. *Frechter* confirms that such provisions are invalid. Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you have questions.

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