

CHANCERY COURT CONFIRMS THAT THE REMOVAL OF DIRECTORS SERVING ON UNCLASSIFIED BOARDS AND ELECTED BY PLURALITY VOTING CANNOT BE LIMITED TO "FOR CAUSE"

Date: 11 January 2016

Corporate/M&A Alert

By: Lisa R. Stark

In *In re VAALCO Energy, Inc. Consolidated Stockholder Litigation*, C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015) (Transcript), the Delaware Court of Chancery confirmed that the certificate of incorporation or bylaws of a Delaware corporation may not limit the removal of directors serving on non-staggered boards to “for cause” removal unless the directors are elected by cumulative voting. The Court’s decision has potentially significant implications for Delaware corporations with plurality voting and non-staggered boards whose charter or bylaw provisions limit the removal of directors to “for cause.”

Background

This action arose after VAALCO Energy, Inc. (“VAALCO”), submitted a proposal to its stockholders at VAALCO’s 2009 annual meeting to completely de-stagger the company’s board of directors, commencing in 2010. VAALCO did not ask its stockholders to approve corresponding amendments to its charter and bylaws, which contained provisions preventing stockholders from removing directors unless the removal was “for cause.” In 2015, activist investors sought to remove a majority of VAALCO’s directors without cause. VAALCO argued that its directors were only subject to removal “for cause.” The activists then brought an action in the Delaware Court of Chancery seeking a declaratory judgment that VAALCO’s charter and bylaws were invalid under Section 141(k) of the Delaware General Corporation Law (the “DGCL”).

Section 141(k) of the DGCL provides: “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” except in the case of (1) a corporation whose board is classified in accordance with Section 141(d) of the DGCL and whose certificate of incorporation does not otherwise provide, and (2) a corporation having cumulative voting. Section 141(d) of the DGCL provides, in pertinent part, that:

The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of the stockholders, be divided into 1, 2 or 3 classes; the term of office of those of the first class to expire at the first annual meeting held after such classification becomes effective; of the second class 1 year thereafter; of the third class 2 years thereafter; and at each annual election held after such classification becomes effective, directors shall be chosen for a full term,

as the case may be, to succeed those whose terms expire....

Analysis

Defendants argued, among other things, that Section 141(d) of the DGCL authorized a single-class, classified board, and that the removal of directors serving on such a board could be limited to “for cause” removal. The Court rejected the argument on the basis that defendants' interpretation of Section 141(d) of the DGCL conflicted with the “standard analysis” of such section and *Rohe v. Reliance Training Network*, 2000 WL 1038190 (Del. Ch. July 12, 2000). The Court also was not swayed by an argument made by defendants that any contrary court ruling would be inconsistent with the certificate of incorporation or bylaws of approximately 175 other public companies identified by VAALCO. Instead, the Court relied on the plain meaning of Section 141(k) of the DGCL quoted above, which it found permitted directors to be removed with or without cause where the directors were elected by plurality voting and served on non-staggered boards.

CONCLUSION AND PRACTICAL IMPLICATIONS

The Court's decision did not invalidate (1) contractual agreements by which stockholders may agree to refrain from voting in favor of the removal of directors absent cause, or (2) certificate of incorporation or bylaw provisions that impose supermajority voting requirements on the removal of directors without cause. The Court's decision also did not address the more nuanced situation where a corporation de-staggeres its board over a period of years (allowing directors to serve out their terms). In such cases, the corporation may have a partially staggered board and arguably a certificate of incorporation or bylaws provision limiting removal to “for cause” could be permissible in some cases.

The VAALCO decision has potentially significant implications for Delaware corporations with plurality voting whose certificate of incorporation or bylaws limit the removal of directors serving on non-staggered boards to “for cause” removal. While the Court's conclusion on the matter is not new, corporations whose certificates of incorporation and bylaws contain provisions similar to those at issue in VAALCO may attract attention from plaintiffs' lawyers who are looking to earn a fee award under Delaware's corporate benefit doctrine for causing corporations to eliminate invalid provisions. As part of their pleadings in the VAALCO action, defendants filed with the court an exhibit listing approximately 175 public companies without staggered boards whose certificate of incorporation and/or bylaws purportedly limited the removal of directors to “for cause” removal. Quick preemptive action by these corporations in particular to eliminate (or to announce their intent to eliminate) any certificate of incorporation or bylaw provisions that run afoul of the VAALCO decision may be useful.

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.