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# THE NUTS AND BOLTS OF MAJORITY VOTING

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Over the past year, a significant number of public corporations have adopted some form of majority voting structure for director elections, largely through governance policies. In order to satisfy the demands of governance activists, many corporations are now considering the adoption of majority voting bylaws (in contrast to policies). Certain features of the bylaws being considered and adopted, however, raise significant questions under Delaware law. Moreover, these features could lead to radical departures from accepted law and practice. Delaware corporations that are considering majority voting should consider the form that a majority voting provision might take, in addition to whether such a provision should be adopted at all (a judgment call we do not discuss in this article).

***The Form Of Majority Voting Bylaw Currently In The Market.*** Although the specific provisions of each majority voting bylaw differ, the typical majority voting bylaw currently endorsed in corporate governance circles contains the following provisions:

- *Voting Standard.* A nominee is elected only if more shares are voted for than withheld from (or, when permitted in the bylaw, voted against) the director's election.

- *Resignation Requirement.* To unseat "holdover" directors who would otherwise remain in office, an incumbent director is required to offer a resignation to the board following a failure to receive a majority vote.

- *Director Recusal.* The director who is required to tender a resignation is prohibited from participating in the board's decision whether to accept the resignation.

- *Contested Election Exception.* The majority voting provision and the resignation requirement do not apply in contested elections, which are defined as elections in which there are more nominees than directorships available. This exception avoids a result in which no candidate receives a majority vote and the incumbent directors hold over in office despite receiving fewer favorable votes than the challengers. The exception allows plurality voting to operate so that challengers are elected under such circumstances.

- *Prohibition On Director Amendment.* Although not "market," directors of certain companies are also deciding whether to adopt a bylaw prohibiting directors from further amending the majority voting provision.

***Potential Problems With These Provisions Under Delaware Law.*** A number of these features raise significant concerns under Delaware law:

- *The Resignation Requirement.* A bylaw should not "require" a director to resign: a resignation is a voluntary act. A binding requirement that a director offer a resignation is simply director removal by another name. Delaware law provides that directors cannot be removed unless at least a majority of the outstanding stock is voted for such removal; furthermore, when a board is staggered, removal can generally be only for cause. *See* DGCL, §§ 141(d) and (k). Bylaws that "require" resignation flout these baseline rules. The recent amendments to Section 141(b) of the DGCL do not authorize bylaws that require director resignations. Rather, Section 141(b) was expressly amended to permit a director to tender an advance, irrevocable resignation, conditioned on the failure to receive a specified vote. Amended Section 141(b) permits a corporation to force a director to honor such an advance resignation, but only because the director has already made the voluntary decision to resign prior to the time the resignation becomes effective.

- *Adding A "Qualification" Bylaw Does Not Address the Issue.* Some corporations are considering the adoption of director qualifications that make a nominee ineligible to hold office as a director unless the nominee consents to abide by the resignation requirement. The DGCL does authorize bylaws that establish "qualifications" for directors. This type of bylaw, however, does not strike us as a bona fide qualification. A director qualification is meant to address a skill or an attribute making a person fit for office. The historical fact that a nominee made a decision whether to abide by the resignation bylaw is not a qualification that speaks to the skills or attributes of a nominee. Rather, this type of provision merely attempts to coerce the actual decisions of a nominee. *Cf.* L. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 Tulane L. Rev. 409, 483 (1998) (expressing doubt that a bylaw, styled as a qualification, could require commitment to a sale of the company as a condition to director election).

- *Limiting The Board's Nomination Power Is Also Problematic.* Companies may also look to adopt bylaws that limit the board's power by requiring directors to nominate only candidates who agree to tender a resignation. By expressly limiting board power to nominate, such a bylaw would draw a company into the debate over the extent to which bylaws can limit board authority. *See Hollinger International, Inc. v. Black*, 844 A.2d 1022, 1079 (Del. Ch. 2004) (noting that "there has been much scholarly debate about the extent to which bylaws can—consistent with the *general* grant of managerial authority to the board in § 141(a)—limit the scope of managerial freedom a board has") (emphasis in original); *cf. Bebchuk v. CA, Inc.*, 902 A.2d 737, 742 (Del. Ch. 2006) (noting that it is "not necessarily clear" that a bylaw limiting the board's power to adopt a rights plan of greater than one-year duration is "facially illegal as an unauthorized impingement upon the board's powers"). Rather than adopt a bylaw that purports to limit the current (and future) directors' power to present any candidates of their choosing for nomination, we believe such a provision should be styled as a board policy, i.e., a standing commitment to nominate only candidates who agree tender resignations.

- *The Recusal Provision Creates Delaware Law Issues.* Although directors often recuse themselves from board decisions that affect their personal interest, it is not clear that a bylaw can force a director to recuse himself from voting on a board decision whether to accept that director's resignation. This type of bylaw essentially provides that a director

is not entitled to vote on a specific board action. However, pursuant to Section 141(d) of the DGCL, a director can be deprived of voting power with respect to one or more decisions only if that director's power is limited in the company charter. DGCL, § 141(d) ("*[T]he certificate of incorporation* may confer upon 1 or more directors . . . voting powers greater than or less than those of other directors.") (emphasis added).

- *Contested Election Provision.* Defining whether an election is contested at the moment of the meeting allows challengers to withdraw their nomination at the last minute, thereby changing the standard from a plurality vote to a majority vote after proxies have been solicited. This rule is likely to lead to confusion and, perhaps, some opportunistic behavior.

- *Prohibiting Further Board Amendment.* Because Section 216 of the DGCL was recently amended to provide that *stockholder-adopted* majority voting bylaws cannot be further amended by directors, companies are beginning to consider bylaw language that would prohibit director amendment of *director-adopted* majority voting bylaws. Practitioners should review the company charter before advising directors to adopt such provisions. Nearly all Delaware corporations include in their charter a provision empowering directors to amend the bylaws, and such provisions typically grant the board unqualified amendment power. Although such charter language is trumped, in the case of stockholder-adopted bylaws, by amended Section 216, that section does not address director-adopted majority voting bylaws. Accordingly, a director-adopted bylaw precluding further director amendment would be invalid if it conflicts with the applicable charter provision that confers amendment power on the directors. *See* DGCL, § 109(b).

***An Alternative Approach.*** This article includes (below) a set of majority voting provisions (bylaws, policy and resignation letter) that address the concerns outlined above.

- *Resignations.* Rather than requiring director resignations following a vote, the form provisions take advantage of the recent amendment to Section 141(b) of the DGCL by seeking resignation letters in which a director irrevocably agrees to resign if he or she fails to receive the required majority vote and the board accepts the resignation.

- *Nominating Process.* To ensure that the board's candidates tender such resignations, the form board policy provides that the board would nominate for election and appoint to board vacancies only candidates who agree to tender, promptly following their election or re-election, the type of advance resignation described above.

- *Advance Notice Statement.* The attached form advance notice bylaw requires that a stockholder nominating candidates for election include in the notice of nominations a statement whether such nominees intend to tender advance resignations if they are elected.

- *Recusal.* The form board policy includes a statement that the board expects a director to abstain from deliberations regarding such director's resignation.

- *Contested Election Definition.* To provide certainty with respect to the election standard for a given meeting, the form bylaws include a provision stating that plurality voting applies if a stockholder has provided the company notice of a nominee for director in accordance with the advance notice bylaw and if such nomination has not been withdrawn as of the tenth day before the company mails its proxy materials to the stockholders.

- *Advance Notice.* Finally, practitioners should monitor the conduct of stockholders using "withhold" or "against" campaigns for gamesmanship and opportunistic behavior. If the use of withhold campaigns becomes abusive, it may be in the best interests of stockholders for companies to modify their advance notice provisions to provide for plurality voting if a withhold campaign is initiated without giving the board sufficient time to respond. (We have not included such a provision in the attached forms.)

***An Additional Technical Consideration.*** Aside from considering the form of a majority voting bylaw, we note one ambiguity in the recent amendment to Section 216 of the DGCL that could affect the board's power to adopt majority voting bylaws in certain circumstances. Section 216 now provides that a stockholder-adopted bylaw specifying the vote for director elections cannot be further amended by the board. However, new Section 216 does not expressly state that it applies only prospectively, i.e., only to bylaws adopted after the August 1, 2006 date the amendment became effective. Accordingly, there is an argument that amended Section 216 applies retroactively, and could preclude the board from adopting a majority voting bylaw if, prior to August 1st, the stockholders adopted the existing bylaw that requires plurality voting. It is far from clear whether the amended statute should be read this way, but practitioners should be aware of the argument. Of course, this ambiguity does not present an issue if either the board or the incorporator adopted the current plurality voting provision.

***Why The Technical Points Matter.*** Practitioners may question whether the enforceability of the majority voting bylaw currently on the market is a real issue. On mandatory resignations, for example, some might point out that the expectation is that a director will choose to resign rather than incur the expense of litigating the validity of a bylaw requiring resignation. Inevitably, however, situations will arise where it will matter whether the provisions actually work. Moreover, even if corporations were willing to accept the risk of invalidity in isolation, corporate practitioners should be sensitive to the precedent that these provisions set for the adopting corporation. As certain classes of stockholders and corporate governance activists seek more direct control over corporate affairs, today's majority voting provisions might lay the groundwork for bylaw proposals that *should* cause corporations, practitioners and investors a significant amount of discomfort. For example:

- What if a stockholder proposed a bylaw requiring a director to tender a resignation if the director does not support a sale of the company? Can a company draw the line between forcing a resignation following a director election and forcing resignation for failing to act as the stockholders desire?

- Consider a bylaw that disqualifies a director from seeking re-election if the director fails to approve a proposal eliminating the company's classified board or rights plan. Stockholders have already made such proposals. Again, can a company draw the line

between a provision that disqualifies a director for one decision (not to agree to resign) as opposed to another decision (not to destagger the board)?

Some may well take the position that all of the above proposals are perfectly valid under Delaware law. We disagree, and we have a sense that others share our view. Our concern is that the majority voting bylaws adopted now may provide a springboard for more aggressive bylaws later.

Some may also take the position that bylaws that force the hands of directors on operational issues are positive developments that will make boards more accountable to stockholders. Again, we disagree: the Delaware corporate form represents a delicate balance between the power of directors to manage the company in the best interests of all stockholders and the rights of stockholders as owners. This balance is reflected by the division between fundamental matters on which stockholders act, such as electing directors and voting on major transactions, and the role of the board—directing the management of the corporation. Despite recent scandals and legitimate concern over compensation issues, the public corporation has been extremely successful at creating wealth for stockholders over the past century and there is no evidence that this basic structure should be altered. There is, on the other hand, real risk that the value of the corporate form will be seriously eroded if radical alterations to the basic structure of public corporations—such as bylaws that automatically remove directors—become commonplace.