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KIRKLAND **M&A UPDATE**

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Director Removal Without Cause — Delaware Default Rule is in Fact the Rule

The recent Vaalco decision highlights that a charter provision that purports to limit director removal for non-classified boards to cases of cause is invalid under Delaware law.

In a recent bench ruling on a summary judgment motion in a case involving Vaalco Energy, Vice Chancellor Laster held that a provision of a company's charter or bylaws could not override the default rule under Delaware law that directors serving on a non-classified board (i.e., annually elected) may be removed with or without cause by vote of holders of a majority of the outstanding shares entitled to vote in director elections. While prior Chancery rulings, including *Nycal* and *Rohe*, reached largely similar conclusions in related circumstances, VC Laster's decision in *Vaalco* clearly articulates his view that this type of charter or bylaw provision that purports to limit director removal for non-classified boards to cases of cause is simply invalid as a matter of Delaware law.

The court held that DGCL §141(k) is unambiguous in setting the default rule, with no room for alteration in the company's governing documents. VC Laster highlighted that the statute provides specific limited exceptions, including for classified boards whose members can only be removed for cause absent a charter provision providing otherwise. By determining the provision was invalid as a matter of law, the company's arguments that a charter amendment was required to remove it or that its removal violated principles of severability were nullified.

Notably, the court rejected Vaalco's assertion based on the relative prevalence of this apparently invalid provision in governing documents of Delaware public companies. VC Laster ruled that the argument that invalidating this charter provision would upset the expectations of some 175 other companies that have similar provisions failed "just as 'all the other kids are doing it' wasn't a good argument for your mother."

The court did not address a somewhat related question of whether a charter or bylaw provision could change the required vote to effect a removal. The same DGCL section (§141(k)) provides that a removal is by the vote of a majority of the shares. However, quite a few companies have governing document provisions that set a super-majority voting requirement for director removal such as two-thirds or 75%. These super-majority requirements appear in charters and bylaws of companies with both classified boards (where removal is only with cause) and annually elected boards (where removal also can be without cause). While some of the same arguments made in this case could be asserted (i.e., DGCL §141(k) does not appear on its face to permit alteration of this default voting rule), a super-majority voting provision, at least in a charter, may be upheld under the separate Delaware provision (DGCL §102(b)(4)) that states that a charter may set a higher voting threshold than set forth in the statute for any matter requiring stockholder approval. In addition, as a matter of policy, a super-majority vote requirement could be viewed as a reasonable impediment to exercising the removal right, as compared to the provision invalidated in this case that was viewed by the court as nullifying a fundamental right of stockholders to remove directors.

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Delaware corporations should review the impact of this ruling on their corporate defense profile as the validity or invalidity of these provisions could impact how an activist stockholder or a hostile bidder plans or executes a challenge to board composition.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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