

Proposed Amendments to the Delaware General Corporation Law to Adopt Majority Voting for Public Companies

Changing the rule in corporate board elections from plurality voting to majority voting in public companies, and establishing this as a mandatory standard, would require the following changes to the Delaware General Corporation Law (“DGCL”):

§ 141. Board of directors; powers; number, qualifications, terms and quorum; committees; classes of directors; nonstock corporations; reliance upon books; action without meeting; removal.

- (a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.
- (b) The board of directors of a corporation shall consist of 1 or more members, each of whom shall be a natural person. The number of directors shall be fixed by, or in the manner provided in, the bylaws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number of directors shall be made only by amendment of the certificate. Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. The certificate of incorporation or bylaws may prescribe other qualifications for directors. Each director shall hold office until such director’s successor is elected and qualified or until such director’s earlier resignation, ~~or~~ removal, or failure to be re-elected. Any director may resign at any time upon notice given in writing or by electronic transmission to the corporation. A resignation is effective when the resignation is delivered unless the resignation specified a later effective date or an effective date determined upon the happening of an event or events. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable. A majority of the total number of directors shall constitute a quorum for the transaction of business unless the certificate of incorporation or the bylaws require a greater number. Unless the certificate of incorporation provides otherwise, the bylaws may provide that a number less than a majority shall constitute a quorum that in no case shall be less than one third of the total number of directors except that

then a board of 1 director is authorized under this section, then 1 director shall constitute a quorum. The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors unless the certificate of incorporation of the bylaws shall require a vote of a greater number.

.....

Commentary:

Section 141(b) needs only this slight clarification to support the majority voting provisions being suggest in § 216(3). Sections 141(b) and 216(3), construed together, anticipate that directors who fail to receive the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote are not re-elected, except if there is a failure to elect sufficient directors to constitute a lawful board according to the company's organizing documents, in which case plurality voting rules would then permit the board to continue in office for a 90-day holdover period. During the 90-day holdover period those directors who had received a majority of affirmative votes would appoint the number of directors necessary to constitute a lawful board according to the company's organizing documents. Those directors who had not received a majority of affirmative votes would not be eligible to be reappointed to fill the vacant seats.

§ 216. Quorum and required vote for stock corporations.

Subject to this chapter in respect of the specialized rules for the vote that shall be required for the election of directors ~~specialized action~~, the certificate of incorporation or bylaws of any corporation authorized to issue stock may specify the number of shares and/or the amount of other securities having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business other than the election of directors, but in no event shall a quorum consist of less than one-third of the shares entitled to vote at the meeting; except that, where a separate vote by a class or series or classes or series is required, a quorum shall consist of no less than one-third of the shares of such class or series or classes or series. ~~In the absence of such specification in the certificate of incorporation or bylaws of the corporation:~~

- (1) In the absence of such specification in the certificate of incorporation or bylaws of the corporation, a majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders;

(2) In the absence of such specification in the certificate of incorporation or bylaws of the corporation, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders;

~~(3) (2) In all matters other than the election of Ddirectors, shall be elected by the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors, unless: subject matter shall be the act of the stockholders;~~

(i) fewer than the minimum number of directors, as defined in the company's articles of incorporation or bylaws is thereby elected, in which case those directors receiving a plurality of the votes cast by the shares entitled to vote, but not a majority, are elected for a holdover period of 90 days (the "holdover directors"), during which time all the directors having received a majority of affirmative votes, and thus duly elected, shall fill the seats of the holdover directors according to the provisions of section 223. If no directors receive a majority of the votes cast by the shares entitled to vote, then those directors receiving a plurality of the votes cast by the shares entitled to vote are elected for a period of 180 days; or

(ii) one or more board seats is contested, in which case directors are elected by a plurality of the votes cast by the shares entitled to vote;
or

(iii) the corporation allows cumulative voting; or

(iv) the shareowners have established a higher voting threshold by adopting a bylaw amendment; or

(v) the corporation has elected to be governed by sections 341-356 establishing a closely-held firm, in which case the certificate of incorporation or the bylaws of the company may vary the majority voting rule for the election of directors; and

~~(3) Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors; and~~

(4) Where a separate vote by a class or series or classes or series is required, a majority of the outstanding shares of such class or series or classes or series, present in person or represented by proxy, shall constitute a quorum entitled

to take action with respect to that vote on that matter and, in all matters other than the election of directors, the affirmative vote of the majority of shares of such class or series or classes or series present in person or represented by proxy at the meeting shall be the act of such class or series or classes or series.

A bylaw amendment adopted by stockholders that specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.

Commentary:

The purpose of this language is to change the voting requirements for director elections from plurality voting to majority voting for publicly held companies, while recognizing exceptions for failed elections, contested elections, cumulative voting, supermajority voting standards, and closely held corporations. In this provision, we suggest a mandatory majority voting rule. A rationale for a mandatory majority voting rule for publicly held corporations is set out below. Under this majority voting regime, if a director fails to receive the affirmative vote of more shares in favor of that director's continuing service than opposed, the director is not elected. A corporation's organizing documents would provide the procedures for appointing a new director (or directors) to fill the vacancies created, which typically would be for the remaining directors to fill the vacancy, as provided for in DGCL § 223.

The statutory approach suggested for majority voting pursuant to § 216(3) has two salutary effects. First, it provides a mechanism to effectuate a robust signal of shareowners' views, one with legal effect, thus promoting board accountability. Second, the power to fill a board vacancy that is created remains with the board, recognizing that Delaware law encourages a balance between board power, as identified in § 141(a), and board accountability, as suggested here in § 216(3).

Exception § 216(3)(i) seeks to balance the interests of board accountability, represented by the mandatory majority voting rule, with the need for continuity on the board in the unlikely event that multiple board members fail to garner majority support, resulting in a board with fewer members than required by the corporation's organizing documents. In that circumstance, which we assume and would hope would be extremely rare, § 216(3)(i) permits the board to be constituted by a plurality of the votes cast by the shares entitled to vote for a holdover period of 90 days, during which time the directors who had received a majority of affirmative votes would fill the number of seats necessary to create a full board using the procedures of § 223. A 90-day holdover period, while likely longer than necessary to fill the vacancies, provides for continuity on the board, and adequate time for the board to reflect on why there had been a failed election, and what characteristics of appointed directors might best address concerns shareowners had demonstrated through their

voting and related communications. Thus, it advances the policy goal of this proposal, which is to better balance board power with accountability to shareowners.

In the extremely unlikely circumstance that an entire board fails to receive a majority of affirmative votes, § 216(3)(i) permits the entire board to be constituted by a plurality of the votes cast for a holdover period of 180 days, during which time the concerns of shareowners can be canvassed and understood and a revised slate of directors prepared for proxy voting. We understand that the potential for failed elections is a concern that has been expressed about a majority voting rule. We submit that § 216(3)(i), in conjunction with the general parameters of § 216(3), should allay those concerns, particularly given the flexibility in § 223 for filling vacant seats on the board.

Exception § 216(3)(ii) continues the plurality voting default rule for contested elections. Proponents of majority voting recognize that plurality voting is appropriate for contested elections.

Exception § 216(3)(iii) recognizes that a cumulative voting regime is inconsistent with a majority voting regime, and so establishes an exception to the majority voting rule in those circumstances.

Exception § 216(3)(iv) recognizes the power of the shareowners to establish a supermajority voting standard for the election of directors in individual companies by adopting a binding bylaw amendment.

Exception § 216(3)(v) carves out closely held companies from the mandatory requirement for a majority voting rule for the election of directors, recognizing that Delaware law permits tailoring of governance arrangements with respect to closely held companies in ways that would not be permitted with respect to publicly held companies. Many governance arrangements permitted in closely held corporations, such as eliminating the board of directors, entering into irrevocable voting trusts or binding shareowner agreements with respect to the exercise of board power, are not permitted in publicly held corporations given the different considerations applicable to the two different situations.

We applaud the revisions of August 2006 to DGCL § 216 that protect shareowner-initiated bylaw changes from further changes by the board. Those revisions are reflected in the last paragraph of § 216. This paragraph of § 216 is still useful, given the mandatory majority voting rule proposed here for the election of directors in public companies, and the concomitant suggested power of the shareowners to establish supermajority voting requirements (a power we expect to be invoked rarely, if ever).

§ 223. Vacancies and newly created directorships.

(a) Unless otherwise provided in the certificate of incorporation or bylaws:

- (1) Vacancies and newly created directorships resulting from any increase in the authorized number of directors elected by all of the stockholders having the right to vote as a single class may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director. If vacancies have been created by a director or directors having failed to receive the affirmative vote of a majority of shares voting in an election, in person or by proxy, those directors having not received a majority of affirmative votes may not be reappointed to fill the vacant seats;
- (2) Whenever the holders of any class or classes of stock or series thereof are entitled to elect 1 or more directors by the certificate of incorporation, vacancies or newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected. If vacancies have been created by a director or directors failing to receive the affirmative vote of a majority of shares of such class or classes of stock or series thereof voting in an election, in person or by proxy, those directors having not received a majority of affirmative votes may not be reappointed to fill the vacant seats.

If at any time, by reason of death or resignation or other cause, a corporation should have no directors in office, then any officer or any stockholder or an executor, administrator, trustee or guardian of a stockholder, or other fiduciary entrusted with like responsibility for the person or estate of a stockholder, may call a special meeting of stockholders in accordance with the certificate of incorporation or the bylaws, or may apply to the Court of Chancery for a decree summarily ordering an election as provided in § 211 or § 215 of this title.

- (b) In the case of a corporation the directors of which are divided into classes, any directors chosen under subsection (a) of this section shall hold office until the next election of the class for which such directors shall have been chosen, and until their successors shall be elected and qualified, unless such directors are being appointed to vacancies created by a director failing to receive the affirmative vote of a majority of shares voting in an election, in which case such appointed director would need to be affirmatively approved by a majority of the shareowners eligible to vote at the next annual shareowner meeting, and such director's term on the board would expire at the same time as the class into which that director has been appointed.

- (c) If, at the time of filling any vacancy or any newly created directorship, the directors then in office shall constitute less than a majority of the whole board (as constituted immediately prior to any such increase), the Court of Chancery may, upon application of any stockholder or stockholders holding at least 10 percent of the voting stock at the time outstanding having the right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorship, or to replace the directors chosen by the directors then in office as aforesaid, which election shall be governed by § 211 or § 215 of this title as far as applicable.
- (d) Unless otherwise provided in the certificate of incorporation or bylaws, when 1 or more directors shall resign from the board, effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote there on to take effect when such resignation or resignations shall become effective, and each director so chosen shall hold office as provided in this section in the filling of other vacancies.

Commentary:

Section 223 of Delaware corporate law contains a range of procedures for filling vacancies on a board of directors. Section 223(a) as currently enacted recognizes that vacancies on the board of directors can be filled by fewer than a quorum of directors, or even by one director, which procedures should serve to allay general concerns about majority voting and the potential for failed elections. Amendments suggested here would establish that those directors in any election who had failed to receive the affirmative vote of a majority of shares voting are not eligible to be reappointed to the vacancies on the board so created. Moreover, amendments suggested here, construed in conjunction with changes suggested to § 216(3)(i), would provide that in the event of an election where fewer directors than the minimum defined in the company's organizing documents received a majority affirmative vote, those directors who had received a majority affirmative vote would appoint the directors to fill the number of seats left vacant and necessary to constitute a full board within 90 days. This provision is consistent with § 223 as currently enacted, which permits even one director to fill vacancies on the board.

Section 223(a)(2) and (b) as currently enacted contain particular provisions for filling vacancies on a classified board. Two changes are suggested here. The first parallels the changes suggested for § 223(a)(1) to the effect that directors who failed to receive a majority affirmative vote are not eligible to be reappointed to the vacancies on the board so created. Section 223(b) establishes that directors appointed to fill a vacancy on a classified board that has been created by a failure to receive a majority affirmative vote would need to be affirmatively approved by a

majority of the shareowners eligible to vote at the next annual shareowner meeting, and in addition provides that their term on the board would be reduced by the one year already served. Classified boards present special accountability problems, and thus appointment for a full term without subsequent shareowner approval would undermine the accountability to the shareowners that these provisions seek to advance.

The following is a rationale for a mandatory majority voting rule for public companies under the DGCL:

Delaware corporate law has long been understood to allow public companies considerable flexibility in structuring their internal governance arrangements. See Leo E. Strine, Jr., Delaware's Corporate Law System, 86 Cornell L. Rev. 1257 (2001). Yet, that flexibility operates within a framework of mandatory provisions concerning the company's relationship with the state and with its shareowners. See Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Columbia L. Rev. 1549 (1989). DGCL §102(a), for instance, sets out a series of mandatory requirements for the certificate of incorporation for companies that wish to incorporate in Delaware. These provisions both permit the state to exercise jurisdiction over companies incorporated in Delaware, by requiring the company to name a registered agent in the state, and to establish important aspects of the capital structure of the company, by requiring the certificate of incorporation to identify the number of authorized shares of stock.

Section 102(a)(3) also requires companies in Delaware to include a statement of the corporate purpose in the certificate of incorporation. The importance of this requirement, and its mandatory nature, was emphasized in the recent case of E-Bay v. Newmark, 16 A.3d 1 (Del. Ch. 2010) (holding that incorporation using an "Inc." corporate form includes a mandatory purpose of increasing shareowner wealth).

The relationship between a company, its directors, and its shareowners is shaped by extensive mandatory provisions, including required mechanisms for director accountability to the shareowners. Thus, shareowners must have the power to elect the board of directors. DGCL § 211(b).

Delaware corporations must hold annual shareowner meetings to elect the board or a portion of it (if the company has a classified board), DGCL § 211(b), and if the company fails to hold an annual meeting the shareowners can bring an action in court to require the meeting be held. DGCL § 211(c). Shareowners have the right to inspect the books and records of the company for a proper purpose, even records going beyond what must normally be publicly disclosed according to federal securities laws. DGCL § 220.

Shareowners have the power to initiate bylaw amendments, and while this power can be shared with the board of directors, it cannot be taken away from the

shareowners. DGCL § 109. Moreover, directors have infeasible fiduciary duties of loyalty and good faith for the benefit of the company and its shareowners, which may not be waived or modified. See *Williams v. Geier*, 671 A.2d 1368, 1381 (Del. 1996).

Thus, as the Delaware Supreme Court has stated in the context of an acquisition, “[t]o the extent that a contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.” *Paramount v. QVC Network, Inc.*, 637 A.2d 34, 51 (Del. 1994). Neither can a public company eliminate the substantive obligations of the board’s fiduciary duty of care, while it can eliminate managerial liability for breaches thereof under DGCL § 102(b)(7). *Malpiede v. Towson*, 780 A.2d 1075, 1095 (Del. 2001) (stating that notwithstanding an exculpation provision under section 102(b)(7) for breaches of the duty of care, plaintiffs can seek injunctive relief to prevent such breaches from occurring or continuing). Many of these mandatory provisions can be varied in a closely held company or an LLC, but none of them can be varied in a publicly held corporation.

Implementing a mandatory majority voting rule for director elections in public companies would thus be consistent with the broad scope of mandatory provisions structuring director accountability to the shareowners in public companies. Moreover, requiring that public company directors being elected in uncontested elections receive a majority vote is consistent with the delegation of power inherent in director elections. The importance of this delegation was emphasized by Chancellor Allen in *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), a case in which a board of directors used powers granted to it in *Blasius Industries’* bylaws to expand the board and appoint new members in an effort to thwart a proxy contest. Holding those actions inequitable even though taken in good faith and in the board’s view of the corporation’s best interest, Chancellor Allen set aside the board’s actions based on the “transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance.” As Chancellor Allen recognized, “[t]he theory of our corporation law confers power upon directors as the agents of the shareholders,” and the mechanism for conferring this legal power is the shareowner vote.

When a director in an uncontested election has received fewer votes for re-election than votes against, it is hard to see how that director can legitimately be called an agent of the shareowners. That close to 80 percent of America’s largest companies have instituted some variation of a majority voting standard suggests that the logic of this statement is compelling. Delaware’s legislature, on the advice of the Council of the Corporation Law Section of the Delaware State Bar Association, should act to implement that logic as a matter of mandatory law.