IN THE SUPREME COURT OF THE STATE OF DELAWARE

CA, INC., a Delaware Corporation,	)	
	)	
Petitioner Below, Appellant,	)	No. 329, 2008
	)	
v.	)	Certification of Questions of Law from the United States Securities and Exchange Commission
	)	
AFSCME Employees Pension Plan,	)	
	)	
Respondent Below, Appellee.	)	

BRIEF OF APPELLANT CA, INC.

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July 7, 2008

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NATURE OF PROCEEDING

This action arises from the certification by the Securities and Exchange Commission ("SEC") to this Court of two questions of law arising in connection with a stockholder proposal for inclusion in CA, Inc.'s ("CA") proxy materials for CA's 2008 Annual Meeting of Stockholders. Specifically, on June 27, 2008, the SEC, pursuant to Supreme Court Rule 41, as amended May 15, 2007, asked this Court to address two questions of Delaware law regarding a proposed stockholder bylaw (the "Mandatory Reimbursement Bylaw" or "Proposed Bylaw") submitted by the AFSCME Employees Pension Plan ("AFSCME") for inclusion in CA's proxy materials, now scheduled to be filed on or about July 24, 2008. This Court granted certification on July 1, and oral argument is now scheduled for July 9 at 10:00 a.m.

SUMMARY OF ARGUMENT

1. By its terms, AFSCME's Proposed Bylaw would usurp the decision-making authority of CA's Board of Directors by directing that "***[t]he board of directors shall cause*** the corporation to reimburse a stockholder," regardless of the particular circumstances, for costs incurred in successfully unseating at least one CA director using a so-called "short slate" of directors (*i.e.*, a set of candidates running for fewer than half the seats on CA's Board).

2. Under settled Delaware law, the decision whether to spend corporate funds on contested director elections rests within the discretion of CA's Board, guided by its fiduciary duties. But the Mandatory Reimbursement Bylaw would be automatic in operation, and leave no role for Board discretion or analysis of whether reimbursement of the costs of a *subset* of CA's stockholders, regardless of their interests and motives, is in the best interests of CA and *all* CA stockholders.

3. This Court's precedents and Sections 102 and 141 of the Delaware General Corporation Law ("DGCL") make clear that any limits on the substantive decision-making authority of a board of directors to manage the business and affairs of a Delaware corporation must be set forth either in the DGCL or in its certificate of incorporation. Neither the DGCL nor CA's Certificate of Incorporation limits the authority of CA's Board over the reimbursement of proxy-related expenses, nor do they allow stockholders or

bylaws to exert power over the reimbursement of such expenses. (*See infra* pages 10-16.)

4. Under settled Delaware law, CA's Board must use its informed business judgment to determine how corporate funds are spent in particular circumstances. In Delaware, corporations may use corporate funds to pay proxy-solicitation expenses of stockholders only when the contest involves clear disagreements over corporate policy issues, not when the contest involves personal disagreements or issues not of concern to stockholders generally. If adopted, the Mandatory Reimbursement Bylaw would direct CA's Board to fund *all* partially successful short-slate proxy contests—regardless of the reasons why the short slate was run, or whether the proxy contest benefited the company or merely the nominating stockholders. Because AFSCME's Mandatory Reimbursement Bylaw would direct CA's Board automatically to spend corporate funds on a particular matter, in a particular way, regardless of the circumstances, this proposal clearly intrudes into the realm of exclusive discretionary Board authority and, thus, violates the DGCL and CA's Certificate of Incorporation. (*See infra* pages 17-21.)

5. In directing CA's Board automatically to reimburse *all* successful short-slate challengers regardless of the circumstances, AFSCME's Mandatory Reimbursement Bylaw ignores the long recognized distinction under Delaware law concerning when proxy-related expenses may be permissibly reimbursed. While particular stockholders can nominate and vote for directors for

any reason, corporate funds may not be used to reimburse proxy-related expenses if the proxy contest was motivated by purely personal or self-serving interests. Moreover, the notion that any short-slate candidate elected to CA's Board automatically reflects the will of a majority of CA stockholders is false; a successful short-slate candidate could be elected by fewer than a matority of the votes cast in a contested election. Under Delaware law, the Board cannot abdicate, nor can any bylaw revoke, the Board's fiduciary duties to all CA stockholders in deciding whether to spend corporate funds. (*See infra* pages 21-35.)

6. Under Section 109(b), stockholder bylaws may only "relate to" the powers of the board of directors. By contrast, Section 102 provides that the certificate of incorporation may "create, limit, define, or regulate" board authority. Because AFSCME's Mandatory Reimbursement Bylaw would eliminate the CA Board's discretion over whether to reimburse the nominator of successful short-slate candidates, the bylaw plainly exceeds the scope of a permissible stockholder bylaw under Section 109(b).

7. While Section 109(b) and other provisions of the DGCL permit stockholder bylaws concerning procedural and organizational matters, no Delaware court has ever held that Section 109(b), standing alone, permits a stockholder bylaw directing a board to expend corporate funds in an area where such bylaw is not specifically authorized by statute. AFSCME does not propose that the CA Board merely "consider" reimbursement if one of a short slate of

director candidates is elected. Rather, the Proposed Bylaw, if approved by this Court, would pave the way for other stockholder bylaws directing boards of Delaware corporations to expend funds for stockholder-preferred purposes and, thereby, would upset the longstanding relationship between the boards and stockholders of Delaware corporations. (*See infra* pages 35-39.)

STATEMENT OF FACTS

1. The Parties

CA is a Delaware corporation, whose business and affairs are currently directed by a twelve-person Board of Directors. Eleven of CA's current directors are independent, and all of CA's directors sit for reelection each year. CA intends to file its definitive 2008 proxy materials with the SEC on or about July 24, 2008. CA's 2008 annual meeting of stockholders is scheduled to be held on September 9, 2008.

AFSCME, a CA stockholder, is associated with the American Federation of State, County and Municipal Employees union. According to its website, AFSCME manages more than $1 trillion in assets invested on behalf of 1.4 million union members. *See* http://www.afscme.org/issues/75.cfm.

2. AFSCME's Mandatory Reimbursement Bylaw

On March 13, 2008, AFSCME submitted its Mandatory Reimbursement Bylaw for inclusion in CA's proxy materials for CA's 2008 annual meeting of stockholders. *See* SEC Certification of Questions of Law ¶ (1)(a) (June 27, 2008) ("SEC Certification"), A78.

Specifically, AFSCME's Proposed Bylaw would amend CA's bylaws to direct CA's Board to "cause the corporation to reimburse" certain stockholders for their proxy-related expenses:

> RESOLVED, that pursuant to section 109 of the Delaware General Corporation Law and Article IX of the bylaws of CA, Inc., stockholders of CA hereby

> amend the bylaws to add the following Section 14 to Article II:
>
> ***The board of directors shall cause*** the corporation to reimburse a stockholder or group of stockholders (together, the "Nominator") for reasonable expenses ("Expenses") incurred in connection with nominating one or more candidates in a contested election of directors to the corporation's board of directors, including, without limitation, printing, mailing, legal, solicitation, travel, advertising and public relations expenses, so long as (a) the election of fewer than 50% of the directors to be elected is contested in the election, (b) one or more candidates nominated by the Nominator are elected to the corporation's board of directors, (c) stockholders are not permitted to cumulate their votes for directors, and (d) the election occurred, and the Expenses were incurred, after this bylaw's adoption. The amount paid to a Nominator under this bylaw in respect of a contested election shall not exceed the amount expended by the corporation in connection with such election.

Id. ¶ (2)(b) (emphasis added).

Neither CA's Certificate of Incorporation nor CA's bylaws contain any specific provision referencing the reimbursement of proxy expenses. Article SEVENTH, Section (1) of CA's Certificate of Incorporation provides:

> The management of the business and the conduct of the affairs of the corporation shall be vested in [CA's] Board of Directors.

A69. Thus, at present, the decision whether to reimburse proxy expenses is squarely vested in the discretion of CA's Board, subject to its directors' fiduciary duties and any applicable Delaware law.

3. CA Requests a "No-Action Letter" from the SEC to Exclude the Mandatory Reimbursement Bylaw

On April 18, 2008, CA's counsel sent a letter to the SEC's Division of Corporation Finance (the "Division") stating that CA proposed to exclude the AFSCME Proposal from CA's 2008 proxy materials under Rule 14a-8 of the Securities Exchange Act of 1934, on the grounds, among others, that the AFSCME Proposal conflicts with Delaware law. A1-9.[1] CA requested from the Division a "no-action letter" stating that the Division would not recommend any enforcement action to the SEC if CA excluded the AFSCME Proposal from its 2008 proxy materials. A1. CA's request for a no-action letter was accompanied by an opinion from CA's Delaware counsel, Richards, Layton & Finger P.A., in which counsel concluded: "[I]n our opinion the Proposal is not a proper subject for stockholder action and, if implemented by the Company, would violate the General Corporation Law." A13.

On May 21, 2008, AFSCME responded to CA's no-action request with a letter of its own (the "AFSCME Letter"), accompanied by an opinion from AFSCME's Delaware counsel, Grant & Eisenhofer P.A. (the "G&E Opinion"). A22-41. The G&E Opinion concluded that the Mandatory Reimbursement Bylaw

[1] Under Sections (i)(1) and (i)(2) of Rule 14a-8, a company may exclude a stockholder proposal from its proxy statement if the proposal "is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization," or if the proposal, if implemented, would cause the company to violate any state law to which it is subject. 17 C.F.R. § 240.14a-8.

"is a proper subject for shareholders and," if enacted, "would be permissible under Delaware law." A29.

4. The SEC Certifies for Decision by this Court Two Questions of Delaware Law

Because the Division was faced with "two conflicting opinions on Delaware law from Delaware law firms," the resolution of those state law issues would determine whether the Division would concur in CA's view that CA may exclude the AFSCME Proposal from its 2008 proxy materials. SEC Certification ¶ (1)(h), A79. At the Division's request, pursuant to Delaware Supreme Court Rule 41, as amended on May 15, 2007, the SEC certified two questions of Delaware state law to this Court:

- Is the AFSCME Proposal a proper subject for action by shareholders as a matter of Delaware Law?
- Would the AFSCME Proposal, if adopted, cause CA to violate any Delaware law to which it is subject?

Id. ¶ (1)(i), A81.

On July 1, 2008, the Court accepted for review the two questions certified by the SEC, concluding that "there are important and urgent reasons for an immediate determination of the questions certified." A85.

ARGUMENT

I. BY MANDATING THE REIMBURSEMENT OF A NOMINATOR'S EXPENSES FOR SUCCESSFUL SHORT-SLATE CANDIDATES, AND ELIMINATING ALL DISCRETION FROM CA'S BOARD, AFSCME'S PROPOSED BYLAW, IF ADOPTED, WOULD VIOLATE DELAWARE LAW.

A. Question Presented

Would the AFSCME Proposal, if adopted, cause CA to violate any Delaware law to which CA is subject?

B. Scope of Review

When addressing a certified question of law, "the normal standards of review do not apply." *State* v. *Anderson*, 697 A.2d 379, 382 (Del. 1997). "This Court must review the certified questions in the context in which they arise." *Id*. The question presented arises as a question of law certified to this Court by the SEC. This Court reviews such questions of law *de novo*. *Outten* v. *State*, 720 A.2d 547, 551 (Del. 1998).

C. Merits of Argument

1. Under Section 141(a) of the DGCL and CA's Certificate of Incorporation, CA's Business and Affairs Are Managed by CA's Board, Not by Stockholder-Adopted Bylaws.

Section 141(a) of the DGCL provides:

> The business and affairs of every corporation . . . 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.

8 *Del. C.* § 141(a). Thus, by its terms, Section 141(a) recognizes only two exceptions to this broad mandate: (1) other provisions of the DGCL; and (2) the corporation's certificate of incorporation.

As this Court has consistently stated, "[a] cardinal precept of the [DGCL] is that directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson* v. *Lewis*, 473 A.2d 805, 811 (Del. 1984); *see also, e.g.*, *McMullin* v. *Beran*, 765 A.2d 910, 916 (Del. 2000) ("One of the fundamental principles of the [DGCL] is that the business affairs of a corporation are managed by or under the direction of its board of directors."); *Quickturn Design Sys.* v. *Shapiro*, 721 A.2d 1281, 1292 (Del. 1998) (Section 141(a) confers on a board of directors the "*full* power to manage and direct the business and affairs of a Delaware corporation" (emphasis in original)).

2. Limitations on the Board's Substantive Decision-Making Authority Must Be Stated in the Certificate of Incorporation or the DGCL.

"Section 141(a) requires that *any limitation on the board's authority* be set out in the certificate of incorporation." *Quickturn*, 721 A.2d at 1291 (emphasis added).[2] This reading of Section 141(a) is consistent with Section

[2] Of course, certain provisions of the DGCL expressly provide that bylaws may regulate certain procedural or organizational matters. *See, e.g.*, 8 *Del. C.* §§ 141(b), (c), 211(a)(1), (b), (d), 216, 222. The DGCL specifically contemplates that a majority of the stockholders of a *close* corporation may execute an agreement that "so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors." *Id.* § 350. But no provision of the DGCL provides that stockholder bylaws may require that a corporation reimburse stockholders in connection with proxy contests.

102(b)(1) of the DGCL, which provides that a corporation's certificate of incorporation may contain "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision ***creating, defining, limiting and regulating*** *the powers of* the corporation, *the directors*, and the stockholders or any class of the stockholders . . . ; if such provisions are not contrary to the laws of this State." 8 *Del. C.* § 102(b)(1) (emphasis added).

Quickturn's holding is also consistent with the language of Section 109(b) of the DGCL. A bylaw adopted pursuant to Section 109(b) may "contain any provision, ***not inconsistent with law or the certificate of incorporation***, ***relating to*** the business of the corporation, the conduct of its affairs, and its rights or powers or *the rights or powers of its* stockholders, *directors*, officers or employees." 8 *Del. C.* § 109(b) (emphasis added). But as this Court has explained, a "corporation's bylaws may never contradict its certificate of incorporation." *Oberly* v. *Kirby*, 592 A.2d 445, 458 n.6 (Del. 1991). Although both "[c]orporate charters and by-laws are contracts among the shareholders of a corporation," a bylaw that conflicts with the charter is a "nullity." *Centaur Partners, IV* v. *National Intergroup, Inc.*, 582 A.2d 923, 928-29 (Del. 1990).

The phrase "except as may be otherwise provided in this chapter" in Section 141(a) does not include bylaws adopted pursuant to Section 109(b). Rather, that language should be interpreted to refer *only* to specific provisions of the DGCL expressly authorizing a departure from the general rule of management by directors, and *not* to open-ended provisions such as Section 109(b). A contrary reading would allow stockholder-adopted bylaws to eviscerate Section 141(a), since any such bylaw would then be "otherwise provided."[3]

AFSCME sets up as a straw man the proposition that "shareholders may only enact bylaws where other sections besides DGCL § 109 give shareholders the right to enact bylaws." G&E Opinion at 7 n.3, A35 (emphasis omitted). That misstates CA's argument, which is merely that Section 109(b) does not authorize bylaws intruding on a board's substantive decision-making authority under Section 141(a). Moreover, it is undeniable that the DGCL provides a number of specific statutory references to permissible bylaws, demonstrating that the drafters understood how to "otherwise provide[]."[4]

Read together, Sections 102, 109, 141 and this Court's precedents in *Quickturn*, *Oberly* and *Centaur Partners* confirm that any "limitation" on (or "definition" or "regulation" of) the board's authority to "manage the business and affairs" of CA *must* appear in the corporate charter or DGCL, *not* in a bylaw. Although a Section 109(b) bylaw may "relate to" the *process* by which a board

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[3] *See generally* Lawrence A. Hamermesh, *The Shareholder Rights By-Law: Doubts from Delaware*, Corp. Governance Advisor, Jan./Feb. 1997, at 9, 11 ("I think [AFSCME's] suggestion reads far too much into the exception in Section 141(a). That exception addresses the narrow instances in which the General Corporation Law explicitly departs from the director management rule, as in Section 291 . . . , and Section 226 . . . . The fact that Section 141(a) is drafted to allow these limited, explicit departures from the director management norm cannot be read to allow an implied, open-ended invitation to depart from that norm through by-law provisions adopted by stockholders.").

[4] *See* 1 David A. Drexler et al., *Delaware Corporation Law and Practice* § 9.05, at 9-10 to -13 (2004) (listing 27 specific references to bylaws in the DGCL, including in Sections 141(b), (c), (d), (f), (g), (h), (i), 142(a), (b) and (e)).

reaches its decision, the ultimate authority to *make* a final decision rests with the board unless the charter provides otherwise:

> [I]n certain areas the directors rather than the stockholders or others are granted the power by the state to deal with questions of management policy. This means that ***our corporation law does not permit actions or agreements by stockholders which would take all power from the board to handle matters of substantial management policy***. This is particularly true absent 100% stockholder approval . . . . Even unanimous shareholder action in this field has limitations.

Abercrombie v. *Davies*, 123 A.2d 893, 898 (Del. Ch. 1956) (emphasis added, internal citations omitted), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957); *cf., e.g., Frantz Mfg. Co.* v. *EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) (bylaws may require that all directors be present to constitute a quorum, and may require unanimous consent for board action); *Hollinger Int'l, Inc.* v. *Black*, 844 A.2d 1022, 1080 n.36 (Del. Ch. 2004) ("Sections 109 and 141, taken in totality, and read in light of *Frantz*, make clear that bylaws may pervasively and strictly regulate the *process* by which boards act, subject to the constraints of equity." (emphasis added)), *aff'd*, 872 A.2d 559 (2005). In short, "[a] court 'cannot give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters.'" *Grimes* v. *Donald*, 673 A.2d 1207, 1214 (Del. 1996) (quoting *Abercrombie*, 123 A.2d at 899).

Consistent with DGCL Section 141(a), CA's Certificate of Incorporation provides that:

> The management of the business and the conduct of the affairs of the corporation shall be vested in its Board of Directors.

Article SEVENTH, Section (1), A69. Neither the DGCL nor CA's Certificate of Incorporation contains any limitation on the CA Board's authority to decide whether to reimburse expenses associated with proxy contests, nor does the Certificate of Incorporation allow stockholder-adopted bylaws to regulate Board authority over expenditures in connection with proxy contests.[5]

Because CA's charter parallels the language of Section 141(a) of the DGCL, the charter imbues CA's Board with all the powers that may be conferred upon a board of directors by the DGCL. Therefore, the Mandatory Reimbursement Bylaw's command that "*[t]he board of directors shall cause* the corporation to reimburse" stockholders for the costs of successful short-slate proxy contests is invalid if that bylaw "limits" the statutory authority of CA's Board in a substantive way.

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[5] By contrast, Article EIGHTH of CA's Certificate of Incorporation explicitly provides that "[t]he corporation *shall*, to the fullest extent permitted by Section 145 of the [DGCL], . . . indemnify any and all persons whom it shall have power to indemnify," which right to indemnity "shall not be deemed exclusive of any other rights to which the indemnified may be entitled under any By Law, agreement, vote of stockholders or disinterested directors or otherwise." A70 (emphasis added). But there is no analogous term in CA's Certificate of Incorporation empowering stockholders or bylaws to restrict the authority of CA's Board in connection with the costs of proxy contests.

As explained *infra* in Section I.C.3, AFSCME's Mandatory Reimbursement Bylaw would "limit" impermissibly the statutory authority of CA's Board by removing the Board's ability to decide how corporate funds are spent. The Mandatory Reimbursement Bylaw does not merely set forth a procedure by which the Board must consider reimbursement requests, nor does it even set forth criteria for the Board to consider in determining how to respond to such requests. Rather, the Proposed Bylaw flatly precludes the Board from exercising its business judgment in any respect with regard to reimbursement of proxy-solicitation expenses in the circumstances specified in the Proposed Bylaw. Because CA's Certificate of Incorporation neither contains such an express limitation nor allows such a limitation to be imposed by bylaw, the Mandatory Reimbursement Bylaw is invalid under *Quickturn*.[6]

[6] There is an academic debate regarding the extent to which a Section 109(b) bylaw may restrict the Board's authority under Section 141(a), because Section 141(a)'s grant of authority to boards of directors is "except as may otherwise be provided in this chapter," while Section 109(b) bylaws cannot be "inconsistent with law." *See Hollinger*, 844 A.2d at 1079 (noting "scholarly debate about the extent to which bylaws can—consistent with the *general* grant of managerial authority to the board in [Section] 141(a)—limit the scope of managerial freedom a board has"). By focusing on the interplay between Section 141(a) and Section 109(b), rather than Section 102, this debate is somewhat misplaced, because Section 102 (but not Section 109) allows the *charter* (but not the bylaws) to "limit" or "regulate" board decision-making authority over substantive matters. In any event, this Court need not attempt to draw a bright line between all permissible bylaws "relating to" board authority and all impermissible bylaws "limiting" that authority. The Mandatory Reimbursement Bylaw's command that CA's Board "shall cause" CA to spend corporate funds clearly falls on the impermissible side of any line.

3. Under Delaware Law, CA's Board Is Empowered To Determine the Nature and Scope of Corporate Expenditures.

Because Delaware law vests the management of the business and affairs of a Delaware corporation in the board of directors, the board, or persons duly authorized to act on its behalf, direct the decision-making process concerning the expenditure of corporate funds. *See*, *e.g*., *Alessi* v. *Beracha*, 849 A.2d 939, 943 (Del. Ch. 2004) (decision whether to initiate buy-sell program for shareholders fell within board's responsibility under Section 141(a)); *UIS, Inc.* v. *Walbro Corp.*, 1987 WL 18108, at *2 (Del. Ch. Oct. 6, 1987) (directors "are charged with deciding what is and what is not a prudent or attractive investment opportunity for the Company's funds").

In another context, this Court has confirmed that "a board's decision on executive compensation is entitled to great deference. It is the essence of business judgment for a board to determine if 'a particular individual warrant[s] large amounts of money, whether in the form of current salary or severance provisions.'" *Brehm* v. *Eisner*, 746 A.2d 244, 263 (Del. 2000) (quoting *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998)).[7] Outside of "rare situations" such as a change in control transaction, *Paramount*

[7] In Delaware, a board of directors has the statutory authority to spend corporate funds on a variety of matters, including setting executive compensation, purchasing and leasing real property, making donations for charitable, scientific or educational purposes, lending money, investing funds, paying pensions, and carrying out profit-sharing and other compensation plans for its employees. *See* 8 *Del. C*. § 122(4), (5), (9), (14), (15).

Communications, Inc. v. *QVC Network*, 637 A.2d 34, 42 (Del. 1994), a court's intrusion into board decisions regarding the use of corporate funds constitutes a "dramatic incursion into the area of responsibility created by Section 141," *UIS*, 1987 WL 18108, at *2.

Like other matters related to the expenditure of corporate funds, the board has traditionally made the decision of whether to reimburse proxy-related expenses. *See, e.g.*, *Steinberg* v. *Adams*, 90 F. Supp. 604, 607 (S.D.N.Y. 1950) (discussing several Delaware cases where the board authorized the payment of proxy-solicitation expenses). It does not matter that the expenditures nominally concern stockholder voting, rather than other aspects of a company's business operations: "'The corporate proxy machinery is just that—*corporate* proxy machinery, constructed of corporate assets, and fueled with corporate funds. Thus, it cannot be appropriated to personal ends.'" *JANA Master Fund, Ltd.* v. *CNET Networks, Inc.*, 2008 WL 660556, at *7 n.59 (Del. Ch. Mar. 13, 2008) (quoting Melvin Aron Eisenberg, *Access to the Corporate Proxy Machinery*, 83 Harv. L. Rev. 1489, 1493-94 (1970)).

Thus, under Delaware law, and in accordance with its fiduciary duties, the CA Board may expend corporate funds to reimburse proxy expenses only "[w]here the controversy is concerned with a question of policy as distinguished from personnel of management." *Hall* v. *Trans-Lux Daylight Picture Screen Corp.*, 171 A. 226, 227 (Del. Ch. 1934); *see also Hibbert* v. *Hollywood Park, Inc.*, 457 A.2d 339, 345 (Del. 1983) (reimbursement permitted where the proxy contest "was actually one involving substantive differences about corporation policy" and where "there was a board resolution . . . which committed the corporation to pay the proxy expenses of any person running for election on the management slate"); *cf. Essential Enters. Corp.* v. *Doresey Corp.*, 1960 WL 56156, at *2 (Del. Ch. Dec. 15, 1960) (ordering former directors to repay the company for proxy-solicitation expenses incurred to advance their "purely personal" objectives).

Where directors, in the fulfillment of their fiduciary duties, exercise their discretion to expend corporate funds by reimbursing proxy expenses for disputes over corporate policy, reimbursement will be upheld under Delaware law. *See, e.g.*, *Hibbert*, 457 A.2d at 340 (whether corporation should hire full-time management and change role of audit committee); *Empire S. Gas Co.* v. *Gray*, 46 A.2d 741, 745 (Del. Ch. 1946) (whether corporation should continue to maintain offices in a specific location); *Trans-Lux*, 171 A. at 229 (whether corporation should pursue merger); *Levin* v. *Metro-Goldwyn-Mayer, Inc.*, 264 F. Supp. 797, 802 n.7 (S.D.N.Y. 1967) (whether corporation should change its dividend policy); *Hand* v. *Mo.-Kan. Pipe Line Co.*, 54 F. Supp. 649, 650 (D. Del. 1944) (whether corporation should pursue liquidation on terms offered by management). Where, on the other hand, stockholders try to force a corporation to pay out funds with no regard to the best interests of the corporation or its stockholders, the nature of the proxy contest or the good faith or motivations of the challengers, reimbursement violates Delaware law.

Delaware's distinction between matters of corporate policy and personal matters reflects the underlying requirement that corporate funds may be spent on proxy contests only where such contests benefit *all*—as opposed to a subset of—stockholders. *See Trans-Lux*, 171 A. at 227-28. Because AFSCME's Mandatory Reimbursement Bylaw would strip CA's Board of the authority to make this decision, taking into account all of the relevant circumstances, this proposal, if adopted, would cause CA to violate Delaware law.

4. AFSCME's Mandatory Reimbursement Bylaw Would Violate Section 141(a) By Usurping the CA Board's Decision-Making Authority Over Whether To Reimburse Proxy-Related Expenses.

The G&E Opinion states that a "bylaw may create guidelines within which directors may exercise their discretionary authority." G&E Opinion at 6, A34. But AFSCME's Mandatory Reimbursement Bylaw does far more than set "guidelines"—this proposal would *prohibit* CA's Board from *using* its "discretionary authority" at all, whenever the conditions set in the Mandatory Reimbursement Bylaw are met.

Under Delaware law, CA's Board of Directors must use its business judgment to determine how corporate funds are spent—and the final decision must be made by CA's Board. But, by its terms, AFSCME's Mandatory Reimbursement Bylaw commands that "***[t]he board of directors shall cause***" CA to reimburse nominating stockholders' proxy-solicitation expenses, without even *considering* the relevant circumstances. Thus, in violation of Section 141(a), the

Mandatory Reimbursement Bylaw would abrogate and usurp the CA Board's fiduciary duty to exercise its informed business judgment concerning the expenditures of corporate funds.

a. The Proposed Bylaw Would Prevent CA's Board From Ensuring that the Company Reimburses Proxy Expenses Only in Contests Over Policy Matters Benefiting All CA Stockholders.

Unlike directors, who are bound by fiduciary duties to all stockholders, individual stockholders have free reign when nominating and voting for directors. Most individual stockholders (including investors who seek a short-term profit rather than waiting for a board's long-term plans to bear fruit)[8] lawfully may nominate directorial candidates or vote for specific candidates for any reason:

> "[E]ach stockholder represents himself and his own interests solely . . . . He may vote contrary to what other stockholders deem to be the best interest of the corporation, or even detrimental to it."

Tanzer v. *Int'l Gen. Indus., Inc.*, 379 A.2d 1121, 1124 (Del. 1977) (quoting Fletcher Cyclopedia, Corporations (Perm. Ed.), § 2031); *see also, e.g.*, *Ringling Bros.-Barnum & Bailey Combined Shows* v. *Ringling*, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may

[8] Section 141 vests in the board the authority to "set a corporate course of action, including time frame, designed to enhance corporate profitability," which may be determined "without regard to a fixed investment horizon." *Paramount Communications Inc.* v. *Time Inc.*, 571 A.2d 1140, 1150 (Del. 1990).

be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.”).[9]

Notwithstanding the unconstrained power of stockholders to nominate directors for any reason, AFSCME’s letter to the SEC, without citing any evidence, merely claimed that it is “beyond dispute” that a challenger “motivated solely by personal or petty concerns” would not succeed in an election. A25. But AFSCME’s unsupported claims do not provide a basis for this Court to ignore that Delaware law requires that the Board exercise its fiduciary duty in deciding whether to reimburse proxy expenses.

In fact, there is no consensus that successful short-slate elections *ipso facto* benefit companies, or that such mechanisms cannot be manipulated to reap private benefits at the expense of the corporation. Boards of directors typically operate by consensus. Unlike a full-slate proxy contest, which, if successful, seats a majority board capable of steering a new direction for the company, a successful short-slate proxy contest by definition results in the election of a *minority* position. Thus, a successful short-slate proxy contest may well lead to dissent but no real changes in corporate policy.

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[9] *See also, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. Rev. 561, 575 (2006) (“Shareholders with private interests . . . might prefer the firm to pursue those interests at the expense of the interests they have in common with other shareholders. . . . [W]hen shareholders have divergent private interests, it is no longer accurate to think of shareholder action as a collective good. . . . Once shareholder action encompasses the goal of maximizing a shareholder’s private benefits . . . shareholders may use their power as shareholders opportunistically.”).

As Vice Chancellor Strine has observed:

> Short slates are oddments to the traditionalist. Boards make decisions collectively, almost invariably by consensus; individual directors do not make business decisions. Traditionalists find contests that involve competing slates more meaningful and productive than contests that single out particular directors for responsibility for decisions that an entire board made. If the goal is to implement a rational system of elections, then stockholders ought to have the opportunity to present a full slate proposing an alternative platform. And when they do not choose to run a full slate, the incumbents ought to be able to point out as an election argument that the insurgents are not willing to propose a full governing board but are simply presenting a few dissenters for the boardroom.

Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 Harv. L. Rev. 1759, 1780-81 (2006).

Short-slate proxy contests of these types can lead to a polarized board of directors where competing factions make it difficult for the board to function.[10] If stockholders truly want to change corporate policy, then a majority of the Board should be replaced through a full-slate proxy challenge. *See* Strine, 119 Harv. L. Rev. at 1768.

Indeed, the decision to run a "short" rather than a "full" slate of directors *itself* raises questions about the nominating stockholder's motives. Of course, some short-slate candidates legitimately could help guide company policy. But stockholders with personal agendas, including political ones, also can use short-slate proxy contests to push a special-interest agenda or to disparage, harass or embarrass an unpopular director—perhaps on an annual basis until the director resigns or is defeated.[11] A corporate raider could plant a single "Trojan Horse"

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[10] *See, e.g., Campbell* v. *Loew's, Inc.*, 134 A.2d 852 (Del. Ch. 1957) (describing proxy dispute between competing factions of directors where neither faction could form a quorum and where faction supported by management had "physical control" of corporate facilities but minority position on board); Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 Bus. Law 67, 82 (2003) ("It is hard to appreciate fully the impact that the addition of special interest or dissident directors has on the operation of a board until one has experienced it firsthand. When it occurs, the board is essentially split into multiple boards."); John F. Olson & Michael T. Adams, *Composing a Balanced and Effective Board to Meet New Governance Mandates*, 59 Bus. Law. 421, 448 (2004) ("Common sense tells us that the constantly carping critic, or the domineering loudmouth who wants to speak at length on every issue, is unlikely to be effective in persuading any group to effective collective action."); Martin Lipton, *Some Thoughts for Boards of Directors in 2006*, Corp. Governance Advisor, Jan.-Feb. 2006, at 1, 4 ("A balkanized board is a dysfunctional board.").

[11] Fostering short-slate proxy contests may deter capable individuals from agreeing to join corporate boards of directors. Some director candidates would not be interested in standing for election to the board if they believe that the nominating process will give rise to a proxy contest. Hence, adoption of the Mandatory Reimbursement Proposal—which undoubtedly will increase the number of short-slate proxy contests—could impair CA's ability to attract accomplished candidates to serve as directors.

director, long in advance of a takeover bid, to disable any defenses that require unanimous consent to activate.[12] Other stockholders may threaten a company with negative publicity unless greenmail is paid, the business is sold or directors focus on short-term profits rather than the long-term health of the company.[13]

Despite AFSCME's speculation that short-slate candidates driven by personal considerations will never win, the question of whether a short-slate proxy contest benefits the corporation is fact-intensive and cannot be made in advance of the decision over reimbursement. The election of a single nominee (even if by a majority of stockholders) is not a valid proxy for the CA Board's determination that reimbursement is in the best interests of CA and all CA stockholders. In fact, that single nominee may be elected under a *plurality* standard, since he or she can

[12] *See Bebchuk* v. *CA, Inc.*, 902 A.2d 737, 739 (Del. Ch. 2006) (describing proposed bylaw that would require unanimous consent to adopt poison pill).

[13] *See, e.g.*, Dane Hamilton, *Activist Investor Preparing for a Busy Year*, Int'l Herald Tribune (Jan. 22, 2008), at 16 (noting that companies that resist activists can "face a barrage of negative publicity that rivals a nasty political campaign, as did Applebee's . . . before it was sold last year to IHOP . . . giving [activist's] fund a 30 percent gain."). Institutional investors owe no fiduciary duty to the corporations whose policies they seek to influence, and may have their own short-term or political goals, rather than the corporation's long-term economic interests, at heart. *See* Strine, 119 Harv. L. Rev. at 1765 ("Those institutions most inclined to be activist investors are associated with state governments and labor unions, and often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest."); Robin Greenwood & Michael Schor, *Investor Activism and Takeovers* (July 2007), *available at* http://ssrn.com/abstract=1003792 (arguing that hedge funds have been effective and primarily interested in pushing relatively small companies into a sale (even at less than a full price) for the sake of obtaining a one-time profit); Anabtawi, 53 UCLA L. Rev. at 579 ("Neither mutual funds nor hedge funds are typically concerned with the long-term success of the companies whose stocks they trade. Instead, they tend to focus on the current market price of a company's stock.").

be elected by votes representing fewer than a majority of those eligible to be cast—and actually cast on other candidates—during the election. Under this standard, whether or not a candidate is elected may depend as much on how many votes are withheld for other candidates as on how many are cast in his or her favor.[14] In other words, a dissident candidate's election may be less a reflection of stockholder support for him or her than a reflection of stockholder opposition to other candidates.

b. The Board Cannot Abdicate, Nor Can a Bylaw Revoke, the Board's Fiduciary Duties to All CA Stockholders.

AFSCME's Mandatory Reimbursement Bylaw purports to do what CA's Board itself could not do—strip any newly elected board of the discretion to decide whether to reimburse the stockholders who ran a short-slate campaign.

[14] In an *uncontested* election, each sitting CA director must garner a *majority* of votes cast on his or her candidacy—*i.e.*, more shares must be voted "for" than "against" the director—for the director to retain his or her seat. CA's Bylaws, Article II, Section 7(b), A48. But in a *contested* election, the majority vote rule would not apply and instead the election would be decided on a *plurality* standard. *Id*. Thus, for example, assuming a Board of 12 seats, up to 17 candidates could be nominated in a short-slate contest (*i.e.*, all 12 sitting CA directors nominated by the Board and up to 5 short-slate candidates nominated by a stockholder). Each share of stock could be voted for 12 nominees (for the 12 Board seats), and the 12 candidates garnering the most votes would win seats on CA's Board. If a certain percentage of shareholders withheld votes on both sides (*i.e.*, for both the sitting directors and the short-slate candidates), then one or more directors could be elected to the board by less than a majority of the votes cast. It is possible that a bloc of stockholders could strategically withhold votes for a particular sitting director, thereby making it possible for a short-slate nominee to prevail with only a small level of support. And if CA faced two five-person short slates (which would result in 22 candidates running for 12 Board seats), it is virtually certain that some winners would garner only a plurality of votes.

Because directors owe unremitting fiduciary duties to the corporation and all CA stockholders, CA's directors themselves could not agree "up front" automatically to reimburse proxy-solicitation expenses in the circumstances specified in AFSCME's Mandatory Reimbursement Bylaw, thereby limiting their ability to exercise their business judgment and fiduciary discretion on a case-by-case basis. As this Court stated in *Paramount Communications Inc.* v. *QVC Network Inc.*:

> To 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.

637 A.2d 34, 51 (Del. 1993); *see also, e.g., Quickturn*, 721 A.2d at 1290-92 (invalidating board's "no hand" poison pill that prevented future directors from redeeming the pill).

In *Time*, this Court determined that Time's board properly enacted defensive measures to thwart a tender offer launched by Paramount—even though that merger may have been attractive to a majority of Time's stockholders:

> Paramount argues that, assuming its tender offer posed a threat, Time's response was unreasonable in precluding Time's shareholders from accepting the tender offer or receiving a control premium in the immediately foreseeable future. Once again, the contention stems, we believe, from a fundamental misunderstanding of where the power of corporate governance lies. Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board representatives. 8 Del. C. § 141(a). *The fiduciary duty to manage a corporate enterprise includes the selection of a time*

> *frame for achievement of corporate goals. That duty may not be delegated to the stockholders*.

571 A.2d at 1154 (emphasis added).

Time teaches that directors' fiduciary duties cannot be circumscribed by the wishes of a majority of stockholders. *See Paramount Communications Inc.* v. *Time Inc.*, 1989 WL 79880, at *30 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990) ("The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares."). Indeed, "minority stockholders must rely for protection solely on the fiduciary duties owed to them by the directors and the majority stockholder, since the minority stockholders have lost the power to influence corporate direction through the ballot." *QVC Network*, 637 A.2d at 43. Absent Board approval, minority CA stockholders can no more be forced to pay for the costs of electing a director whom they oppose than they could be forced to accept a merger opposed by the Board.[15]

A board may exercise informed discretion on a *reimbursement* decision only after the proxy contest has been completed, all votes have been tallied and all money has been spent. Because CA's Board could not abdicate its

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[15] To the extent that dicta in *Unisuper Ltd.* v. *News Corp.*, 2005 WL 3529317, at *6 (Del. Ch. Dec. 20, 2005), suggest the contrary, they conflict with the principle that directors owe fiduciary duties to *all* stockholders. For example, this Court has held that a board has the power to adopt unilaterally a stockholder rights plan, even if some stockholders oppose the implementation of that rights plan. *Leonard Loventhal Account* v. *Hilton Hotels Corp.*, 780 A.2d 245, 249 (Del. 2001).

fiduciary responsibilities to *all* CA stockholders in advance (by signing a contract as in *QVC Network* or adopting a poison pill as in *Quickturn*), neither can a bylaw enacted by a majority of stockholders thwart the exercise of the Board's duties.[16]

c. The Mandatory Reimbursement Bylaw Could Result in the Waste of Corporate Assets.

AFSCME asks this Court to allow the wishes of a bare majority of CA's current stockholders[17]—without any input from CA's Board—***to preapprove*** the payment of an unspecified amount of corporate funds, to an unidentified stockholder proposing an unknown short slate of directors, for unknown reasons, at an unidentified time in the future. Had CA's Board blindfolded itself in such a manner, the Board properly would be accused of breaching its fiduciary duty of care and ignoring the potential waste of corporate assets.

Taking into account the relevant circumstances, directors must make decisions "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson*, 473 A.2d at 812. "The determination of whether a business judgment is an informed one turns on

[16] In *Blasius* v. *Atlas*, 564 A.2d 651, 661-62 (Del. Ch. 1988), the Delaware Court of Chancery rejected a *per se* rule to strike down any board action that is taken for the primary purpose of interfering with the voting process, because such a rule "may sweep too broadly" and prohibits a case-by-case determination of whether future situations would warrant a board action thwarting a stockholder vote. Thus, as demonstrated by *Blasius*, uncertainty counsels against the imposition of a per se/mandatory rule in stockholder-voting contexts.

[17] *See* Article IX of CA's bylaws, A60 (providing that the bylaws may be amended "at any annual or special meeting of the stockholders, by the affirmative vote of the holders of not less than a majority of the outstanding shares of stock of the Corporation entitled to vote on such action").

whether the directors have informed themselves '*prior to making a business decision*, of all material information reasonably available to them.'" *Smith* v. *Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (emphasis added) (quoting *Aronson*, 473 A.2d at 812). "A director's duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders." *Id.* Where stockholders' money is at stake, "[r]epresentation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information." *Id.* A director's failure to inform himself or herself prior to making a decision breaches that director's fiduciary duty of care. *Id*. at 872-73, 893.

In addition, under Delaware law, the expenditure of corporate funds in particular raises important questions about fiduciary duties, and the board has a special role to play in overseeing those expenditures. Among other things, directors may be held personally liable for actions resulting in the waste of corporate assets, and directors' actions involving corporate waste are not protected by the business judgment rule. *See, e.g.*, *Brehm* v. *Eisner*, 906 A.2d 27, 73-74 (Del. 2006). The board's special responsibility for overseeing the proper management of corporate assets is no less relevant when those assets are to be used to reimburse proxy-solicitation expenses. Consequently, bylaws that would mandate expenditures without a determination as to whether the expenditures are appropriate raise serious questions about the role of the board and the ability of the directors to discharge their special responsibility for the management of corporate assets.

Proxy contests are distracting and may be "extraordinarily expensive." *JANA Master Fund*, 2008 WL 660556, at *4. AFSCME's Mandatory Reimbursement Bylaw would lead to an increase in proxy contests and to an increase in the expenditure of corporate funds, which will be borne by all of CA's stockholders. For example, even if only *one* nominee on the short slate is elected, the Mandatory Reimbursement Bylaw, by its terms, would require the reimbursement of *all* proxy expenses for the entire short slate. Thus, if a challenger runs a short slate of five nominees, and only one of those nominees is elected, CA would have to reimburse the challenger's proxy expenses for all five nominees. The Mandatory Reimbursement Bylaw therefore eliminates the CA Board's discretion to determine whether to reimburse none, one-fifth or all of these expenses, wastefully encouraging dissident stockholders to propose large (but still "short") slates to increase the chances that at least one nominee will be elected.[18]

In fact, AFSCME's Mandatory Reimbursement Bylaw could expose CA to an expensive carnival of short-slate contests. Instead of coordinating to run a single "full slate" of directors, multiple stockholder groups might each propose a "short slate" in the hopes of having their individual costs reimbursed. If three short slates of five nominees each were run, and one nominee were elected from each short slate, CA would be forced by the Mandatory Reimbursement Bylaw to reimburse the proxy expenses for *all fifteen nominees*—even though no corporate policy had changed, and the sole result would be a balkanized board. The potential expense is exacerbated at corporations such as CA that hold elections

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[18] Although the Mandatory Reimbursement Bylaw purports to put a "cap" on reimbursement (*i.e.*, reimbursement "shall not exceed the amount expended by the corporation in connection with such election"), these provisions may invite litigation. It may be difficult to isolate the amount expended by the company attributable to the election of directors when there are multiple items on the ballot, and the company may not believe the insurgent's expenditures were "reasonable." Moreover, the "cap" on expenses purports to apply separately with regard to each "Nominator," so that in any case where stockholders propose multiple, separate short slates independently of one another, the stockholders could demand that the cap be applied separately with regard to each slate. Thus, if there were three short slates proposed, the dissident stockholders could pressure the company to reimburse their solicitation expenses up to an aggregate amount equal to three times the amount expended by the company on its own solicitation effort. That could be very costly for the company and the rest of its stockholders.

annually for all of its directors. The Mandatory Reimbursement Bylaw leaves CA's Board powerless to discourage such wasteful tactics.[19]

Waste of corporate assets is a breach of fiduciary duty that may be ratified only by a *unanimous* vote of the stockholders, not by a majority vote. *See Michelson* v. *Duncan*, 407 A.2d 211, 219-20 (Del. 1979); *Kaplan* v. *Goldsamt*, 380 A.2d 556, 567-68 (Del. Ch. 1977). The Mandatory Reimbursement Bylaw does not require unanimity. (Indeed, it does not even require that a majority of stockholders approve expense reimbursement in any particular short-slate contest; because reimbursement is made automatic, there is no check on corporate waste whatsoever.)

* * *

In short, where directors, in the fulfillment of their fiduciary duties, exercise their discretion to expend corporate funds by reimbursing proxy expenses for disputes over corporate policy, Delaware courts will uphold such reimbursement. But where stockholders try to force a corporation to pay out funds with no regard to the best interests of the corporation or its stockholders, the nature of the proxy contest or the good faith or motivations of the challengers—as

[19] *See, e.g.*, Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 Iowa L. Rev. 485, 547 (1994) ("The current rule, by forcing a voting challenger to bear the full risk of an unsuccessful contest, gives the board a powerful tool for distinguishing between the well-meaning suitor and the opportunistic striker.").

does AFSCME's Mandatory Reimbursement Bylaw—reimbursement violates Delaware law.

II. SECTION 109(B) DOES NOT AUTHORIZE A STOCKHOLDER BYLAW DIRECTING A BOARD TO SPEND CORPORATE FUNDS FOR PREFERRED "POLICY" PURPOSES.

A. Question Presented

Is the AFSCME Proposal a proper subject for action by shareholders as a matter of Delaware Law?

B. Scope of Review

The appropriate standard of review is *de novo*. *See supra* Section I.B.

C. Merits of Argument

As set forth in Section I, AFSCME's Mandatory Reimbursement Bylaw, which seeks to limit the authority of CA's Board without specific authorization in the DGCL or CA's Certificate of Incorporation, exceeds the scope of a permissible Section 109(b) bylaw and, therefore, is invalid under the DGCL and this Court's precedents.

1. AFSCME Rests on Inapposite Cases Concerning Stockholder Bylaws Bearing No Resemblance to Its Mandatory Reimbursement Bylaw.

The G&E Opinion, submitted by AFSCME to the SEC, cited Vice Chancellor Strine's decision in *Hollinger* for multiple propositions: (1) that "it is entirely consistent with the grant of authority to directors under DGCL § 141(a) for bylaws to regulate the conduct of directors" (G&E Opinion at 3, A31); (2) that "bylaws may regulate how directors exercise their fiduciary duties by constraining their ability to act" (*id.*); (3) that bylaws may "pervasively and strictly regulate the process by which boards act" (*id*. at 6, A34); and (4) that "shareholders [have] broad power to enact bylaws," including to abolish a committee created by the board of directors (*id.* at 7-8, A35-36).

Hollinger involved a bylaw expressly permitted by statute. The Court of Chancery in *Hollinger* held that a stockholder-adopted bylaw amendment disbanding most of a board's committees did not violate Section 141(a). The court's rationale was based on Section 141(c)(2), which expressly provides for the regulation of board committees through the adoption of bylaws. 844 A.2d at 1079-80. Vice Chancellor Strine's opinion merely confirms the well-established principle that bylaws may regulate board *procedure*:

> Traditionally, the bylaws have been the corporate instrument used to set forth the *rules by which* the corporate board *conducts its business*. To this end, the DGCL is replete with specific provisions authorizing the bylaws to establish the *procedures* through which board and committee action may be taken. . . . [T]here is a general consensus that bylaws that regulate the *process* by which the board acts are statutorily authorized.

Id. at 1078-79 (emphasis added). But *Hollinger* does not stand for the proposition that a bylaw may *revoke* the substantive decision-making authority of a board of directors (rather than a board committee) to take any particular course of action, such as whether to expend funds for a particular purpose.[20]

The G&E Opinion's citation to *Gentile* v. *SinglePoint Fin., Inc.*, 787 A.2d 102 (Del. Ch. 2001), likewise sheds no light on the permissible scope of a Section 109(b) bylaw. *See* G&E Opinion at 3-4, A31-32. *Gentile* dealt with a bylaw regarding indemnification, a matter which Section 145 of the DGCL *specifically* provides may be regulated by bylaw.[21] By contrast, the Mandatory Reimbursement Bylaw has no specific statutory authorization, but must fall within the scope of Section 109(b).

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[20] Although restrictive procedural bylaws (such as those requiring the presence of all directors and unanimous board consent to take action) are acceptable, *see Frantz*, 501 A.2d at 407, even "procedural" bylaws can unduly intrude upon board authority. *See Bebchuk*, 902 A.2d at 742 (bylaws that purported to "abolish[] the board of directors" or "attempt[ed] to force the board to meet only at the North Pole in the dead of winter" would be "obviously invalid").

[21] Section 145(f) provides that "[t]he indemnification and advancement of expenses provided by . . . the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise." The G&E Opinion reaches too far in suggesting that the existence of bylaws allowing mandatory indemnification and advancement of expenses under Section 145 proves the validity of the Mandatory Reimbursement Bylaw—this argument actually proves the opposite. The general mandate of board discretion in Section 141(a) is specifically subject to exceptions "as may be otherwise provided in this chapter or in its certificate of incorporation." 8 *Del. C.* § 141(a). Section 145 is an exception "provided in this chapter." Thus, it should be no surprise that a bylaw adopted pursuant to Section 145 can mandate certain payments: Section 145 is a statutory exception to the general rule.

2. The Mandatory Reimbursement Bylaw Is Not a Board-Imposed Contractual Obligation.

AFSCME's Mandatory Reimbursement Bylaw involves ***stockholder-imposed*** limitations on board decision-making over corporate expenditures. Nevertheless, the G&E Opinion relied heavily on Chancellor Chandler's opinion in *Unisuper Ltd.* v. *News Corp.*, 2005 WL 3529317 (Del. Ch. Dec. 20, 2005), even though *Unisuper* has nothing whatsoever to do with stockholder bylaws. Specifically, the G&E Opinion cites *Unisuper* for the proposition that "it is entirely consistent with the grant of authority to directors in DGCL § 141(a) for bylaws to regulate the conduct of directors." G&E Opinion at 3, A31. A review of the facts makes clear that AFSCME's reliance on the case is misplaced.

In *Unisuper,* News Corp., an Australian corporation, sought to reorganize in Delaware. 2005 WL 3529317, at *1. Such reorganization required the approval of News Corp.'s public stockholders. *Id*. Under Australian law, stockholder approval was required to adopt a stockholder rights plan; under Delaware law, stockholder approval was not needed. *Id*. Therefore, in an effort to garner stockholder support for the proposed reorganization, the News Corp. board stated that it would adopt a "board policy" that any rights plans enacted by the board without stockholder approval would expire after one year, unless ratified by stockholders. *Id*. at *3. Weeks later, the reorganization was approved by News Corp.'s stockholders. *Id.*

Two weeks after the reorganization, News Corp.'s board adopted a poison pill, without stockholder approval. *Id.* The board then announced that its policy might not apply in the future, but that its application would depend on whether the policy was "appropriate in light of the facts and circumstances existing at such time." *Id.* One year later, News Corp.'s board extended the poison pill without a stockholder vote. *Id*.

Certain News Corp. stockholders sued, alleging, *inter alia,* breach of contract and promissory estoppel. The court observed:

> [A]ny contract a board could enter into binds the board and thereby limits its power. *Section 141(a) does not say the board cannot enter into contracts.* It simply describes who will manage the affairs of the corporation and it precludes a board of directors from *ceding that power* to outside groups or individuals.

Id. at *6 (emphasis added). Although observing that "a promise to adopt a board policy . . . is a more transitory right than a charter provision," *id.* at *4, the court refused to dismiss plaintiffs' claims for breach of contract and promissory estoppel, holding that "[t]he burden is now on the plaintiffs to prove that a contract or promise was actually made that the Board Policy would be irrevocable," *id*. at *10.

Chancellor Chandler's decision certifying an interlocutory appeal in *Unisuper*—which the G&E Opinion fails to mention—sheds further light on his opinion. *See Unisuper Ltd.* v. *News Corp.*, 2006 WL 207505 (Del. Ch. Jan. 20, 2006). Thus, Chancellor Chandler stressed:

> [F]or purposes of this appeal, *defendants have conceded that there was a contract.* In fact, it is beyond dispute that there was a "package" of contracts and promises made between plaintiffs and the Company in the months leading up to News Corp.'s re-incorporation as a Delaware corporation. It also is uncontroverted, at this stage, that without these "agreements" the re-incorporation would not have occurred.
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> * * *
>
> News Corp. thus finds itself in a stew of its own making. News Corp. easily could have included language in the Press Release or Letter to Shareholders . . . stating that the Company's board *reserved the right to rescind the board policy*.

Id. at *1-*2 (emphasis in original).

In *Unisuper*, therefore, the context of the court's discussion was one in which the board voluntarily agreed that the exercise of its authority would be subject to ratification by the stockholders, but failed to reserve the right to retract the board's contractual promises.[22] Similarly, in *In re Nat'l Intergroup, Inc. Rights Plan Litig.*, the Court found that the board could agree, by a contract with

[22] The G&E Opinion's reliance on dicta regarding stockholders having the power to "specify what the corporate contract is to say" or to "fill a particular gap in the corporate contract if they wish to fill it" misreads the corporate contract. G&E Opinion at 9-10, A37-38 (quoting *Unisuper*, 2005 WL 3529317, at *8). The corporate contract comprises both bylaws *and* the corporate charter. *See Centaur Partners*, 582 A.2d at 928. The DGCL provides that the corporate charter may be amended to limit the authority of the board of directors only with the consent of *both* the Board and a majority of stockholders. 8 *Del. C.* § 242(b)(1). *Unisuper* hardly stands for the proposition that a mere majority of stockholders can rewrite the terms of the corporate contract—potentially prejudicing the rights of minority stockholders—without amending the certificate of incorporation. *Cf. Lehrman* v. *Cohen*, 222 A.2d 800, 804, 808 (Del. 1966) (with board approval, stockholders *unanimously* amended charter to "provide[] how the corporation is to be managed, as is [stockholders'] privilege and right under Section 141(a)").

its stockholders, not to adopt a new stockholder rights plan or to extend the term of its existing plan without a stockholder vote. 1990 WL 92661, at *6-*7 (Del. Ch. July 3, 1990).

The conflict between AFSCME's Mandatory Reimbursement Bylaw and the statutory authority of directors to manage the corporation's business and affairs is confirmed by this Court's decision in *Hibbert*, which AFSCME erroneously dismisses as "inapposite" here. (G&E Opinion at 5, A33.) *Hibbert* concerned whether former directors of a corporation who lost their bid for reelection could recover their proxy expenses. 457 A.2d at 340. This Court held that reimbursement was proper, because the "election dispute was one over corporate policy." *Id.* More important, however, was the fact that there was "a board resolution . . . which committed the corporation to pay the proxy expenses of any person running for election on the management slate." *Id.* at 345. Accordingly, this Court held that the trial court "could properly compel the corporation to make good on that commitment." *Id.*

Thus, a board may *voluntarily* obligate the corporation to reimburse proxy expenses, including the expenses incurred by an insurgent shareholder. Likewise, ordinary corporate contracts executed with board approval, such as loan agreements, may "limit a board's authority to authorize certain corporate actions, such as dividends." John C. Coates & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post-*Quickturn *Alternatives*, 56 Bus. Law. 1323, 1331 (Aug. 2001). Indeed, a board's decision to bind itself contractually is an exercise of its authority under Section 141(a) to manage the corporation's business and affairs.[23] But the G&E Opinion ignores the difference between a board's *decision* to bind itself by contract and an attempt by stockholder bylaw to impose a decision on the board.

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Whether or not the reimbursement of the expenses of successful short-slate directors is good corporate policy is not before this Court. Rather, the question before this Court is whether Section 109(b) permits a stockholder bylaw that directs the board of directors of a Delaware company to spend funds, regardless of whether the board believes that such expenditures are in the company's best interests in the circumstances presented.

Upholding the Mandatory Reimbursement Bylaw would open the door to myriad bylaws limiting board authority under Section 141(a). *See*, *e.g*., *Bebchuk*, 902 A.2d at 737 (proposed bylaw limiting board's authority over poison pills); *Gen. DataComm Indus., Inc.* v. *Wisc. Inv. Bd.*, 731 A.2d 818 (Del. Ch. 1999) (proposed bylaw prohibiting board from repricing stock options). If AFSCME's Mandatory Reimbursement Bylaw were permissible under Section

[23] *See, e.g., Sample* v. *Morgan*, 914 A.2d 647, 671-72 (Del. Ch. 2007) ("Boards of directors necessarily limit their future range of action all the time. For example, a core function of boards is to 'manage' the business and affairs of the corporation. One aspect of management involves procuring the factors of production the company needs to do its business. If a board enters into a five-year exclusive agreement to purchase energy, that necessarily limits its freedom to manage its procurement of energy. But that does not mean that the board has 'abdicated' its authority to manage, it means that the board has exercised its authority." (footnotes omitted)).

109(b), why couldn't a bylaw force a board to pay for *all* proxy challenges to incumbent directors (no matter how frivolous or costly) or to subsidize special-interest shareholder campaigns?[24] Simply put, there is no limiting principle to AFSCME's reading of Section 109(b).

Because Section 141(a) and CA's Certificate of Incorporation entrust to CA's Board the decision-making authority over the reimbursement of proxy-related expenses, this Court should hold that the Proposed Bylaw is not a permissible subject for a stockholder bylaw. This Court should reject AFSCME's effort to open the door to waves of stockholder bylaws seeking to limit board authority over substantive matters long left to board discretion.

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[24] *See, e.g.*, *Avista Corp.*, 2008 SEC No-Act. LEXIS 357 (Mar. 6, 2008) (shareholder resolution nominally regarding corporate governance but with supporting statement regarding hydroelectric dams and salmon populations); *Yahoo! Corp.*, 2008 SEC No-Act. LEXIS 420 (Feb. 1, 2008) (encouraging Internet company to promote democracy in China).

CONCLUSION

For the foregoing reasons, CA respectfully requests that the Court hold (1) that the AFSCME Proposal is not a proper subject for action by stockholders as a matter of Delaware law, and (2) that the AFSCME Proposal, if adopted, would cause CA to violate Delaware law.

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