

July 17, 2008

Delaware Supreme Court Reaffirms Director-Centric Corporate Governance

Today's decision by the Delaware Supreme Court in the *AFSCME/CA* matter ([see our July 1, 2008 memorandum, "SEC Staff Refers Questions on Validity of Mandatory Bylaw Proposal on Proxy Solicitation Expenses to Delaware Supreme Court"](#)) is an important reaffirmation that Delaware will adhere to the director-centric view of corporate governance. It significantly clarifies a question, much debated in connection with activist stockholder proposals under Rule 14a-8, concerning the extent to which stockholders can propose binding bylaw amendments (as opposed to precatory proposals) for vote by stockholders.

The decision, issued in response to the first-ever request for clarification to the Delaware Supreme Court by the SEC, invalidated under Delaware law a proposed stockholder bylaw that would have obliged the board of directors to reimburse stockholders for the reasonable expenses of a successful short-slate proxy solicitation. Justice Jacobs' opinion held that the bylaw violated the fundamental principle that directors cannot be forced into a course of action that would preclude them from discharging fully their fiduciary duties as they see them – even in the form of a direction from the stockholders.

Importantly, the Court's opinion makes clear that the statutory provision authorizing stockholder-adopted bylaws is itself subordinate to the statutory command that it is the board of directors that manages the business and affairs of every Delaware corporation. The court ruled that the scope of the statutory provision authorizing stockholders to adopt bylaws is "limited by the board's management prerogatives" under the statute because the board's authority to manage the corporation is "a cardinal precept" of Delaware law. Under this reasoning, a binding bylaw proposal to prohibit a board of directors from adopting or implementing a poison pill would similarly be invalid.

The Delaware Supreme Court's unequivocal and welcome holding should discourage further efforts by stockholder activists to erode the fundamental prerogatives of the board of directors. The opinion will hopefully signal that the courts will not permit directors to be undermined or constrained in the exercise of their fiduciary duty in the broad range of subjects traditionally within their ambit as stewards of the corporation.

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