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Delaware Supreme Court Addresses Majority Voting Standards in Director Elections

A recent Delaware Supreme Court decision has significant implications for corporations with majority voting standards where incumbent directors fail to receive the required level of support and tender their resignations to the board of directors. The decision, *City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc.*, provides stockholders with a roadmap for inspecting a corporation’s books and records after a board refuses to accept the directors’ resignations.

Background

In *Axcelis*, the corporation had a “plurality plus” governance policy in which directors were elected by a plurality of the votes cast but were subject to a board policy that required directors to tender their resignations if the votes cast “withheld” were greater than the number of votes cast “for” such persons. At its 2008 annual meeting, the three directors who sat on the corporation’s classified board of directors failed to receive majority support from the stockholders and tendered their resignations. The board, however, refused to accept their resignations, noting that one of the directors was the corporation’s lead independent director and each of them sat on key board committees.

Following the annual meeting, the City of Westland Police & Fire Retirement

System, a pension fund and Axcelis stockholder, demanded to inspect the corporation’s books and records pursuant to Section 220 of the Delaware General Corporation Law. The purpose of the demand was to investigate, among other things, “the Board members’ compliance with their fiduciary duties to the Company and its shareholders as it relates to the Board’s refusal to accept the resignations” of the directors who failed to receive majority support. When the demand was refused, the pension fund brought suit in the Delaware Court of Chancery, which held that the pension fund failed to state a “proper purpose” and did not allege any “credible basis from which to infer any possible wrongdoing” that would justify its request.

Delaware Supreme Court’s Opinion

The Delaware Supreme Court affirmed the lower court’s ruling that the pension fund failed to state a “proper purpose” to inspect the company’s books and records, as required by Delaware law. It agreed that the board’s refusal to accept the directors’ resignations did not raise a credible basis to infer that the directors were acting out of “improper entrenchment motives.” The court also agreed that the board’s refusal to accept the resignations did not trigger the *Blasius* standard, which requires a board to demonstrate a compelling

justification when it interferes with a stockholder vote. The court explained that to do so would improperly shift to the corporation the burden of establishing a “proper purpose.”

The Delaware Supreme Court then explained that determining an individual’s suitability to serve as a director is a proper purpose. Citing prior case law in *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810 (Del. Ch. 2007), the court held that a stockholder can inspect a corporation’s books and records under such circumstances if:

- the stockholder establishes a credible basis from which to infer there are legitimate concerns regarding a director’s suitability, which can be established by showing that the board refused to accept the resignation of a director who failed to receive majority support from the stockholders under the company’s majority voting policy;
- the stockholder’s true and primary purpose for inspecting books and records is not improper; and
- the information requested is “necessary and essential to assess[] whether a director is suitable to stand for reelection.”

The court explained that “[t]he less-than-majority shareholder vote may be viewed as a judgment by the holders of a voting majority that those director-candidates were no longer suitable to serve (or continue to serve) as directors” and that the board’s “decision not to accept those resignations may be viewed as a contrary, overriding judgment by the Board.” It continued that “[w]here, as here, the board confers upon itself the power to override an exercised shareholder voting right without prior shareholder approval ..., the board should be accountable for its exercise of that unilaterally conferred power. *At stake ... is the integrity of the Board decision overriding the determination by a shareholder majority*” (emphasis added). Thus, the court dismissed the plaintiff’s complaint because it framed its request the wrong way.¹

Implications

Axcelis has significant implications for companies that have adopted majority voting policies, which include nearly two-thirds of the S&P 500®. It almost ensures that a stockholder demand to inspect books and records (as well as related stockholder litigation) will follow a board’s decision not to accept director resignations. This is

¹ The Delaware Supreme Court also rejected the stockholder’s request to inspect books and records relating to the board’s refusal to accept a takeover proposal, concluding that there was no credible basis to believe the board’s decision was anything but a “good faith business decision[].”

significant because books and records inspections typically are precursors to derivative litigation. In evaluating a demand, *Axcelis* dictates that the pivotal issues will be (1) whether the stockholder has an ulterior motive that is an “improper purpose,” (2) whether the documents are necessary and essential to evaluating the director’s suitability to serve on the board,² and (3) the terms of any confidentiality agreement that might be necessary to maintain the confidentiality of the information requested by the stockholder.

As a result, boards that are considering director resignations must carefully consider all relevant factors and document their process. Withhold campaigns already generate significant stockholder and media attention. Boards must now recognize that not just their decision to refuse a resignation, but also the process by which they considered it, will be subject to scrutiny.

One aspect of *Axcelis* that may draw criticism is the court’s view that the board had “confer[red] upon itself the power to override” a shareholder vote “without prior shareholder approval (as would be required in the case of a shareholder-adopted by-law or a charter provision).”

² On this issue, it remains to be seen whether a withhold campaign reflecting general disagreement with corporate performance or strategy, rather than the merits of an individual’s suitability to serve as a director, will influence the types of documents to which the stockholder is entitled.

The stockholders, however, were entitled only to a plurality vote under the corporation’s governing documents, so it was the board that had created this conditional policy. In addition, it is not clear whether the court’s analysis would change if the stockholders had approved a majority voting standard that permitted the board to refuse a resignation.

Another aspect of *Axcelis* that merits attention is whether the court’s focus on how the board “overrode” a stockholder vote will extend to other stockholder proposals. *Axcelis* can be seen as an extension of prior Delaware cases that afford special treatment to director elections. As the Court of Chancery stated in a different context in *Mercier v. Inter-Tel (Delaware), Inc.*, 929 A.2d 786, 811 (Del. Ch. 2007), “[t]he notion that directors know better than the stockholders about who should be on the board is no justification at all” for taking coercive defensive actions. Other stockholder proposals, however, such as ratification of a stockholder rights plan or a say-on-pay proposal, relate to key managerial decisions made by directors. In light of the board’s statutory mandate to manage the corporation, a good faith disagreement with the stockholders on such issues arguably should not warrant greater judicial scrutiny or open the door to books and record demands.

If you have any questions about these matters, please contact [Gary E. Thompson](#), [Steven M. Haas](#), or your Hunton & Williams LLP contact.

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