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Delaware Rules on "Without Cause" Director Removal

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The Delaware Court of Chancery recently held that a corporation without a classified board or cumulative voting may not restrict stockholders' ability to remove directors without cause. *In re Vaalco Energy S'holder Litig.*, C.A. No. 11775-VCL (Dec. 21, 2015). The ruling gives rise to questions for the many companies with similar charter or bylaw provisions.

In 2009, Vaalco's stockholders approved an amendment to the company's certificate of incorporation to declassify the board, but the amendment left intact clauses in the bylaws and charter providing that directors could be removed only for cause. When an activist investor launched a consent solicitation to remove four members of the board in late 2015, Vaalco responded that any such written consent would be "null and void" because its directors could "only be removed from office for cause." Stockholder plaintiffs sued, arguing that under § 141(k) of the Delaware General Corporation Law, stockholders have the right to remove directors without cause unless the company has a staggered board or cumulative voting.

In a transcript ruling, the Court of Chancery agreed and invalidated the terms of Vaalco's charter and bylaws providing that directors may be removed only for cause. Shortly thereafter, Vaalco reached a resolution with the activist investor.

The practical significance of the ruling for the scores of other companies with unclassified boards whose charters allow director removal only "for cause" remains to be determined. Even if the Delaware Supreme Court confirms the Vaalco rule—and the Supreme Court has not had the opportunity to pass on the issue—a without-cause removal right may be of limited importance, especially for companies whose charter and bylaws do not provide low thresholds for stockholder-called special meetings. More fundamentally, a board vulnerable to a without-cause removal campaign is likely equally vulnerable to a proxy fight at an ensuing annual meeting. In many cases, therefore, the *Vaalco* rule is unlikely to have real-world impact in a contested election scenario.

But stockholder plaintiffs may seek to capitalize on the ruling nonetheless, by bringing suit or demanding that boards comply with the *Vaalco* rule and then claiming a fee if a conforming change is made. Confronted with such a claim, companies will have the option to settle or litigate the matter in the Court of Chancery and the Supreme Court. Given the tactical complexity of these governance and litigation choices, companies affected by the *Vaalco* ruling should consider carefully whether a response is in order.