

GORMAN V. SALAMONE: UPDATING DELAWARE LAW ON THE REMOVAL OF OFFICERS BY STOCKHOLDERS

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The power to remove officers is usually reserved for a Delaware corporation's board of directors. Express language in a certificate of incorporation can reserve this power for stockholders, and until recently, Delaware courts had not addressed if bylaws can do the same. In *Gorman v. Salamone* (Del. Ch. July 31, 2015), the Delaware Chancery Court answered this question, striking down a bylaw that granted stockholders the power to remove officers. The court reasoned that the bylaw was invalid as a matter of law because "such a bylaw would unduly interfere with directors' management prerogatives by preventing them from discharging one of their most important functions."

Background

John Gorman, the majority stockholder in Westech Financial Inc., attempted to remove the company's CEO. Normally a majority stockholder could accomplish this by electing a friendly slate of directors and having those directors remove the officer. However, Gorman was limited by a voting agreement that prevented him from electing a majority of the board. He attempted to maneuver around this agreement by executing a stockholder consent to create a new bylaw allowing stockholders to appoint and remove officers directly. Then, pursuant to the new bylaw, he removed the CEO.

Holding

The Delaware Chancery Court's holding relies on the principle that director primacy is a bedrock principal of Delaware law. It reasoned that, absent authorization in a corporation's certificate of incorporation, stockholders may not interfere with this principal by directly managing the corporation's business and affairs. Bylaws may not mandate how a board decides *substantive* business decisions, but may define the *process and procedures* by which those decisions are made. The court held that a stockholder removing an officer is a substantive business decision and is invalid as a matter of law.

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Practical Applications

Gorman is particularly relevant to corporations with controlling or activist stockholders. If corporations have provisions in their certificates of incorporation or voting agreements that limit the ability of controlling parties to remove directors, this decision effectively insulates their officers from direct removal by a stockholder. Further, activist stockholders of public companies frequently wage proxy contests on bylaw amendments during takeover attempts; this decision, at least in the context of officer removal, eliminates that tool from their arsenal.

- If the parties desire that a stockholder *should* have the right to directly remove officers (or directors) and appoint their replacements, the certificate of incorporation should provide express authorization of that right.
- This case is a product of a long series of litigation between these parties and will probably be appealed to the Delaware Supreme Court. Since this appears to be an issue of first impression under Delaware law, the Supreme Court may reverse or narrow the current holding.

If you have questions regarding shareholder powers, bylaws, or other issues in Delaware Corporate law, contact one of the attorneys listed in the sidebar.