Certified Trouble Ahead For Activist Shareholders?: The SEC, Delaware Certification & Shareholder Bylaw Proposals After CA, Inc. v. AFSCME Employees Pension Plan

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After CA, Inc. v. AFSCME Employees Pension Plan

The relationship between shareholders’ power to adopt bylaws and the board of director’s power to manage the business and affairs of the corporation has been an unsettled, and contentious, issue. The Supreme Court of Delaware, in CA, Inc. v. AFSCME Employees Pension Plan, directly addressed this issue and established a framework for examining proposed shareholder bylaws. The case arose through the first use of the newly amended certification procedure that permits the SEC to certify questions to the Supreme Court of Delaware for resolution. AFSCME submitted a bylaw for inclusion in CA’s 2008 proxy materials that would require CA to reimburse the reasonable proxy expenses of a shareholder who nominated a short slate of directors and had at least one nominee elected. CA sought to exclude the proposed bylaw and requested no-action relief from the SEC. Faced with conflicting legal opinions from Delaware law firms regarding the bylaw’s permissibility, the SEC utilized the Delaware certification procedure and certified two questions to the Supreme Court of Delaware: (1) Was the proposed bylaw the proper subject of shareholder action?; and (2) If enacted, would the proposed bylaw cause CA, Inc. to violate Delaware law? After an expedited briefing and argument the Court answered both questions in the affirmative. The bylaw was the proper subject of shareholder action because it related to the director election process. However, lacking a fiduciary out, it would prevent CA’s board from fully discharging its fiduciary duties, causing CA to violate Delaware law. Examination of the reasoning in CA reveals that the court was willing to look past the mandatory nature of the bylaw because it related to the director election process. If the same method of analysis is applied to other bylaws, outside the director election context, such bylaws would be found impermissible. While CA was a victory for shareholders because it found the proposed bylaw to be permissible under Delaware law, the court’s analysis will likely limit the permissibility of future shareholder bylaws that encroach upon the board’s power to manage the business and affairs of a corporation.
# Table of Contents

I. **Introduction** ..................................................................................................................4  

II. **AFSCME’s Proposed Bylaw, CA’s No-Action Request & SEC Certification** ..................6  
   A. **AFSCME’s Short Slate Proxy Expense Reimbursement Bylaw** ..............................6  
   B. **CA’s No-Action Request & Unsettled Questions of Delaware Law** .....................8  
   C. **SEC Certification to the Supreme Court of Delaware** .........................................11  
   D. **The Certification Process and Resolution of Unsettled Questions of State Law in No-Action Requests** .........................................................................................13  

III. **The Supreme Court of Delaware’s Decision in CA, Inc. v. AFSCME Employees Pension Plan** .........................................................................................................................16  
   A. **First Certified Question: Is the Proposed Bylaw A Proper Subject for Shareholder Action?** .................................................................................................................17  
      i. Shareholders’ Section 109(a) Bylaw Proposal Power is Limited by the Board’s Section 141(a) Power to Manage the Corporation’s Business and Affairs .................................................................17  
      ii. Shareholder Bylaws May Establish or Regulate the Process for Board Decision-Making, But Not Mandate the Decisions Itself ..................................................20  
          1. The Relationship Between DGCL Sections 109(b) & 102(b)(1) ..................20  
          2. Delaware Judicial Decisions Upholding Process-Oriented Bylaws ..........21  
      iii. The Proposed Bylaw Is a Proper Subject of Shareholder Action Because The Bylaw’s Intent and Effect Concerns Regulation of Director Election Process .................................................................23  
      iv. The Court Will Likely Determine Bylaws Outside The Context of the Director Election Process Infringe Upon The Board’s Power to Manage the Business and Affairs of the Corporation .................................................................25  
          1. Is the Proposed Bylaw Now Excludable From CA’s Proxy Statement Under Rule 14a-8(i)(8)? ..................................................................................27  
   B. **Second Certified Question: Would the Proposed Bylaw Cause CA To Violate Delaware Law?** .................................................................................................................29  
      i. The *Quickturn & QVC* Fiduciary Out Requirement ........................................31  
      ii. The Proposed Bylaw Would Cause CA to Violate Delaware Law Because the Bylaw Would Not Permit CA’s Board to Fully Discharge Its Fiduciary Duties .................................................................................................................32  

IV. **Conclusion** ..................................................................................................................36  
   A. **Shareholder Bylaw Proposals After CA, Inc. v. AFSCME Employees Pension Plan** .........................................................................................................................37  

-3-
I. INTRODUCTION

The debate over shareholders’ ability to adopt bylaws limiting a board of director’s managerial discretion is an unsettled, and contentious, issue in Delaware Law.¹ The tension between a board’s power to manage the affairs of the corporation, and shareholders’ power to adopt bylaws is built into the Delaware General Corporation Law without an explicit resolution.² The Supreme Court of Delaware, in CA, Inc. v. AFSCME Employees Pension Plan, squarely addressed this conflict and established a framework to analyze proposed shareholder bylaws.³ The case came to the Supreme Court of Delaware in the form of two certified questions from the Securities and Exchange Commission. CA marked the first time the SEC employed Delaware’s certification procedure, which had been recently amended to permit its use by the SEC.

At issue was a bylaw proposed by the AFSCME Employee Pension Plan for inclusion in CA’s proxy materials for its 2008 annual shareholders meeting. The proposed bylaw would require CA to reimburse reasonable proxy expenses of a shareholder who nominated a short slate⁴ of directors when at least one nominee was elected. CA sought no-action relief from the SEC permitting exclusion of the bylaw. The SEC received conflicting legal opinions from CA and AFSCME regarding the bylaws permissibility under Delaware law. Prior to the newly amended Delaware certification procedure, the SEC, when faced with unsettled issues of state

¹ See Lawrence A. Hamermesh, Corporate Democracy and Shareholder-Adopted By-Laws: Taking Back the Street?, 73 Tulane L. Rev. 409, 416 (1998) (“There is an obvious zone of conflict between these precepts: in at least some respects, attempts by stockholders to adopt by-laws limiting or influencing director authority inevitably offend the notion of management by the board of directors.”); see also Bebchak v. CA, Inc., 902 A.2d 737, 742 (Del. Ch. 2006) (“[D]ivergent authorities concerning the validity of stockholder bylaws which limit a board of director’s exercise of one of its power . . . is fraught with tension.”).

² Compare 8 Del. C. § 141(a) (vesting the management of the “business and affairs” of corporation in board of directors) with 8 Del. C. § 109(b) (permitting shareholder bylaws “relating to the business of the corporation, and the conduct of its affairs”); see John C. Coffee, Jr., The SEC and the Institutional Investor: A Half-Time Report, 15 Cardozo L. Rev. 837, 889 (1994) (“[P]ersuasive Delaware authority is simply lacking that draws boundaries between the shareholder’s right to amend the bylaws and the board’s right to manage.”).


⁴ A “short slate” of directors is a set of nominees for less than half the seats on a corporation’s board of directors. For example, a short slate of directors for CA’s twelve member board would consist of five or fewer nominees.
law, would have denied no-action relief and avoided a determination on the matter. However, equipped with the certification procedure, the SEC could now obtain resolution of unsettled issues of Delaware law, and grant or deny no-action relief accordingly. The SEC certified two questions to the Supreme Court of Delaware, inquiring: (1) whether the proposed bylaw was the proper subject of shareholder action under Delaware law, and (2) whether the proposed bylaw, if enacted, would cause CA to violate Delaware law.

The Court answered both questions in the affirmative holding that a process-oriented shareholder bylaw could, in some ways, limit the board’s ability to manage the affairs of the corporation, but could not limit the board’s capacity to fully discharge its fiduciary obligations. The proposed bylaw was the proper subject of shareholder action because it was process-oriented and did not mandate a substantive decision of the board. However, if enacted, CA would violate Delaware law because it did not permit the CA’s board to fully discharge its fiduciary duties by requiring reimbursement in situations where the board’s fiduciary duties would compel denial.

Finding the bylaw to be a proper subject of shareholder action under Delaware law was a boost to shareholder activists who have worked to include such proposals in several corporations’ proxy materials. While the Court recognized proxy reimbursement was a proper subject of shareholder action, the Court’s reasoning and analysis, as well as its requirement of a fiduciary out, will limit permissible future shareholder bylaw proposals. AFSCME’s proposed bylaw related to the director election process, which is an area that Delaware courts have long applied a heightened level of diligence and scrutiny in their review. Bylaws requiring similar board action outside of the director election context will likely be impermissible because they mandate substantive business decisions rather than simply regulating the decision making

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5 A “fiduciary out” is a provision allowing the board to use its discretion according to its fiduciary duties when implementing a bylaw.
process. Further, the requirement that a board have a fiduciary out will undercut any bylaw because most decisions will receive deferential analysis under the business judgment rule.

Part II discusses AFSCME’s Proposed Bylaw, CA’s request for no-action relief, and the SEC’s certification to the Supreme Court of Delaware. Part III examines the Supreme Court of Delaware’s response to the certified questions. Part IV concludes by examining CA’s potential effect on future shareholder bylaw proposals.

II. AFSCME’S PROPOSED BYLAW, CA’S NO-ACTION REQUEST & SEC CERTIFICATION

A. AFSCME’s Short Slate Proxy Expense Reimbursement Bylaw

CA, Inc. (“CA”)6 is a Delaware corporation with a twelve member non-classified board of directors.7 CA’s 2008 annual meeting was scheduled for September 9, 2008, and CA intended to file its definitive proxy materials with the SEC on or about July 24, 2008.8 On March 13, 2008, AFSCME Employees Pension Plan (“AFSCME”)9 notified CA that it intended to present a proposed bylaw amendment, pursuant to Rule 14a-8, at CA’s 2008 stockholders meeting.10

AFSCME’s proposed bylaw amendment (“Proposed Bylaw”) read:

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, including,

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7 CA, 953 A.2d at 229; see also CA, Inc., Restated Certificate of Incorporation (Mar. 8, 2006).
8 CA, 953 A.2d at 229.
9 AFSCME is associated with the American Federation of State, County and Municipal Employees union. See AFSCME – About AFSCME, http://www.afscme.org/about/aboutindex.cfm.
10 Gerald W. McEntee, Chairman, AFSCME Employees Pension Plan Letter to Kenneth Handal, Executive Vice President, Global Risk & Compliance, and Corporate Secretary, CA, Inc., at 1 (Mar. 13, 2008) available at http://law.du.edu/images/uploads/corporate-governance/sec-governance-ca-certified-questions.pdf [hereinafter McEntee Letter]. AFSCME was the beneficial owner of 39,753 shares of CA voting common stock, having held the shares for more than one year, and asserted no “material interest” other than that shared by all stockholders of CA. Id.
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.\footnote{CA, 953 A.2d at 229-30; see also McEntee Letter, supra note 10, at enclosure.}

At the time of AFSCME’s proposal, CA’s Certificate of Incorporation and bylaws contained no provision regarding proxy expense reimbursement specifically.\footnote{CA, 953 A.2d at 230.} Any reimbursement was governed by the broad powers vested in the board of directors by CA’s Certificate of Incorporation.\footnote{See CA, Inc. Restated Certificate of Incorporation, art. SEVENTH, § (1) (Mar. 8, 2006) (“The management of the business and the conduct of the affairs of the corporation shall be vested in [CA’s] Board of Directors.”); CA, 953 A.2d at 230 (same).} However, if the Proposed Bylaw were adopted, the shareholder who nominates a short slate of directors, and has at least one candidate elected, would be reimbursed for reasonable expenses incurred during the election.\footnote{CA, 953 A.2d at 237.}

Included with the Proposed Bylaw was a Supporting Statement urging shareholders to approve the bylaw.\footnote{McEntee Letter, supra note 10, at enclosure.} AFSCME stated that the lack of reimbursement for “short slate” election contests was a cause for the lack of such contests.\footnote{McEntee Letter, supra note 10, at enclosure. Even if a stockholder is successful in such an election, a short slate by definition—less than a majority of directors—lacks the power to approve any reimbursement for election expenses.} Shareholders’ power to elect directors was, in AFSCME’s opinion, the “most important mechanism” to ensure that directors manage a corporation in shareholders interests.\footnote{McEntee Letter, supra note 10, at enclosure. AFSCME’s citation to “corporate law scholars” for the proposition that director elections are a “safety valve” justifying broad directorial discretion is a reference to Prof. Lucian Bebchuk mentioned in the following paragraph of the Supporting Statement. \textit{Id.}; see Lucian Arye Bebchuk, \textit{The}}
asserted that this safety valve was ineffective unless there was a realistic threat of director replacement—a threat that AFSCME contended did not exist at CA. They, thus, to encourage short slate elections, and make the safety valve effective at CA, AFSCME submitted the Proposed Bylaw.

B. CA’s No-Action Request & Unsettled Questions of Delaware Law

On April 18, 2008, counsel for CA sent a letter (“CA No-Action Request”) to the SEC Division of Corporation Finance (“Division”) seeking confirmation that the Division would not recommend enforcement action if CA excluded the Proposed Bylaw from its 2008 annual meeting proxy materials.

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*Case for Shareholder Access to the Ballot, 59 BUS. LAW. 43, 44 (2003) (“In the structure of our corporate law, shareholder power to replace directors is supposed to provide an important safety valve. ... This shareholder power, in turn, provides incumbent directors with incentives to serve shareholders well, making directors accountable.”); see also Lucian A. Bebchuk, Letting Shareholders Set The Rules, 119 HARV. L. REV. 1784, 1795-97 (2006) (advocating reform of director election process to make it easier for shareholders to replace incumbent directors); Lucian Arye Bebchuk, The Case For Increasing Shareholder Power, 118 HARV. L. REV. 833, 870-75 (2005) (proposing a system allowing shareholders to initiate and adopt rules-of-the-game changes in corporate governance).*

19 McEntee Letter, supra note 10, at enclosure. The Supporting Statement actually reads “We do not believe such a threat currently exists at most U.S. public companies, including Dell.” Id. (emphasis added). However, in context, this is clearly a typographical error. Further evidence of the error is the fact that AFSCME submitted substantially the same bylaw proposal for inclusion in Dell, Inc.’s 2008 proxy materials. See Dell, Inc., Form DEF 14A, at 15-16 (filed June 6, 2008). The proposed bylaw, in that case, was included in Dell’s 2008 proxy materials, but, was not passed, receiving only 34% of the vote. See Dell, Inc, 2008 Annual Meeting of Stockholders, Final Proxy Results (July 18, 2008) available at http://www.dell.com/downloads/global/corporate/sec/FY08_Proxy_Final_Vote_Results.pdf.

CA sought exclusion of the Proposed Bylaw based on sections (i)(1)\textsuperscript{21}, (i)(2)\textsuperscript{22}, (i)(3)\textsuperscript{23}, and (i)(8)\textsuperscript{24} of Rule 14a-8.\textsuperscript{25} By mandating reimbursement, CA asserted, the Proposed Bylaw was an attempt to circumvent the board and obtain reimbursement without board approval if at least one candidate from a proposed short slate was elected.\textsuperscript{26} CA emphasized that the Proposed Bylaw was not precatory and left the board no discretion when making a reimbursement decision.\textsuperscript{27} Enclosed with CA’s No-Action Request was an opinion by CA’s Delaware counsel, Richards, Layton & Finger P.A., supporting CA’s assertion that the Proposed Bylaw violated Delaware law.\textsuperscript{28}

\textsuperscript{21} See 17 C.F.R. § 240.14a-8(i)(1) (permitting exclusion “[i]f the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company’s organization”). CA asserted that Section 141(a) of the Delaware General Corporation Law vests management authority in the board, and contemplates restrictions on this authority through amendments to the certificate of incorporation, not the bylaws. CA No-Action Request, supra note 20, at 7.

\textsuperscript{22} See 17 C.F.R. § 240.14a-8(i)(2) (permitting exclusion “[i]f the proposal would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject”). CA stated that the Proposed Bylaw, if enacted, would cause CA to violate Delaware General Corporation Law and CA’s certificate of incorporation because it deprives CA’s board of the power to manage expenditure of corporate funds. CA No-Action Request, supra note 20, at 6. The Proposed Bylaw “effectively vests in the stockholders, rather than the board, the ability to manage the corporate assets in this context” of proxy expense reimbursement. Id. at 7.

\textsuperscript{23} See 17 C.F.R. § 240.14a-8(i)(3) (permitting exclusion “[i]f the proposal . . . is contrary to any of the Commission’s proxy rules”). CA argued that the Proposed Bylaw conflicts with Rule 14a-7, which requires shareholders to bear the expense of their proxy materials. CA No-Action Request, supra note 20, at 8; see also 17 C.F.R. § 240.14a-7. By shifting the cost to CA when the election of a shareholder proposed director occurs, the Proposed Bylaw “would override the cost-allocation procedure established by Rule 14a-7.” CA No-Action Request, supra note 20, at 8.

\textsuperscript{24} See 17 C.F.R. § 240.14a-8(i)(8) (permitting exclusion “[i]f the proposal relates to a nomination or an election for membership on the company’s board of directors . . . or a procedure for such nomination or election”). The Proposed Bylaw, CA argues, relates to the procedure for the election of directors by facilitating contested director elections. CA No-Action Request, supra note 20, at 3. Though it does not require inclusion of shareholder candidates in CA’s proxy statement, CA argued that, effectively, the Proposed Bylaw forces CA to include them. Id. at 5. CA could include the shareholder candidates or reimburse proxy expenses at “a cost that is likely to be substantially greater than the cost of simply including the candidate.” Id. at 5. Rule 14a-8(i)(8) should not allow a shareholder “to coerce, or establish a financial incentive for,” CA to include that shareholder’s proposed director candidates. Id. at 5-6.

\textsuperscript{25} CA No-Action Request, supra note 20, at 1.

\textsuperscript{26} CA No-Action Request, supra note 20, at 2.

\textsuperscript{27} CA No-Action Request, supra note 20, at 2.

On May 21, 2008, AFSCME responded to CA’s No-Action Request. AFSCME stated that CA failed to meet its burden under Rule 14a-8(i)(8), (i)(1) & (i)(2), or (i)(3) to permit exclusion of the Proposed Bylaw. Enclosed with AFSCME’s Response was an opinion from AFSCME’s Delaware counsel, Grant & Eisenhofer P.A., discussing why the Proposed Bylaw was proper and did not violate Delaware law. On June 3, 2008 CA replied to AFSCME’s response stating that CA’s reasons for exclusion remained valid and AFSCME’s letter merely stated opposing arguments that failed to address key issues raised by CA.

Ultimately, the Division disagreed with CA’s assertion that it could exclude the Proposed Bylaw based upon Rule 14a-8(i)(3) or Rule 14a-8(i)(8). However, with regards to exclusion

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30 AFSCME argued CA’s position that the Proposed Bylaw could be excluded under the director election exclusion “relie[d] on an implausible interpretation” of the exclusion that was supported by neither the language or policy goals. Id. at 2. The Proposed Bylaw would not lead to contested director elections or permit proxy contests outside of the SEC’s proxy disclosure rules. Id. at 2-3.

31 AFSCME stated that Delaware law grants broad authority to shareholders to adopt bylaws. Id. at 4. Further, Delaware law permits bylaws that constrain a board of director’s action, including with regard to the expenditure of corporate funds. Id. AFSCME also asserted that shareholder bylaws could limit the board’s managerial power under Section 141(a). Id. (citing Unisuper Ltd. v. News Corp., 2005 WL 3529317 (Del. Ch. 2005)).

32 AFSCME asserted that Rule 14a-7 does not prevent corporations from implementing a different cost allocation for a shareholder soliciting proxies. AFSCME No-Action Response, supra note 29, at 5. The SEC does not intend Rule 14a-7 to be the exclusive means for a shareholder distributing proxy materials, and has recognized that state inspection statutes supplement Rule 14a-7. Id. Further, AFSCME cites two no-action letters rejecting similar arguments to the one made by CA with respect to Rule 14a-7. Id. (citing Apache Corp., SEC No-Action Letter, 2007 WL 465553 (Feb. 8, 2007); Bank of New York Co., Inc., SEC No-Action Letter, 2006 WL 538773 (Feb. 28, 2006)).


34 David B. Harms, Sullivan & Cromwell LLP Letter to Securities and Exchange Commission, Office of Chief Counsel, Division of Corporation Finance (June 3, 2008) available at http://law.du.edu/images/uploads/corporate-governance/sec-governance-ca-certified-questions.pdf [hereinafter CA No-Action Reply]. One issue CA identified was AFSCME did not address the practical implications of the Proposed Bylaw and the financial incentive it would create for CA to include shareholder nomination in CA’s proxy statement. Id. at 1. Another issue CA raised was AFSCME failed to appreciate that shareholder bylaws may regulate the process by which the board makes a decision, but not regulate the board’s discretion to make the decision itself. Id. at 2-3.

under Rule 14a-8(i)(1) or Rule 14a-8(i)(2), the Division was faced with no Delaware case on point and conflicting opinions of the applicable Delaware law.  

C. SEC Certification to the Supreme Court of Delaware  

On Friday, June 27, 2008 the General Counsel to the SEC submitted to the Supreme Court of Delaware (“Court”) two questions certified by the Commission regarding the Proposed Bylaw. The Commission, at the Division’s request, made the certification to obtain resolution of significant questions of Delaware law, which would aid the Division in evaluating CA’s no-action request as well as any similar future requests.  

The questions certified by the Commission inquired:  

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

The certification was the first ever submitted by the SEC pursuant to the recently amended Article IV, Section 11(8) of the Delaware Constitution, permitting the Court to hear questions of law certified by the SEC, and Supreme Court of Delaware Rule 41.  

36 See CA No-Action Request, supra note 20, at 8 (“[T]here is no Delaware court case directly on point . . . .”); RLF Opinion Letter, supra note 28, at 2 (“There is no Delaware case that specifically addresses the validity of the Proposed Bylaw . . . .”).  
39 SEC Certification, supra note 38, at 4.  
41 CA, 953 A.2d at 229 n.1. Supreme Court of Delaware Rule 41 provides “the United State Securities and Exchange Commission . . . may, on motion or sua sponte, certify to this Court for decision a question or questions of law arising in any matter before it . . . .” Del. Sup. Ct. R. 41(a)(ii); see also Cartwright Letter, supra note 37, at 1 (“In accordance with Supreme Court Rule 41, as amended May 15, 2007 to allow for certification by the Securities and Exchange Commission, I am enclosing . . . the Commission’s Certification with respect to question of Delaware Law. . . . This is the first time the Commission has utilized this certification procedure.”).
The SEC determined that the questions should be certified to the Supreme Court of Delaware for four separate reasons. First, the Proposed Bylaw raised unsettled questions of Delaware law—exemplified by the conflicting opinions of RLF and G&E—relating to the interpretation of the Delaware General Corporation Law “which has not, but should be, settled by the Court.” Second, the resolution of the certified questions would determine whether AFSCME may require CA to include the Proposed Bylaw in its proxy materials. Third, in the application of Rule 14a-8 to the Proposed Bylaw, issues of Delaware state law are controlling, which can be resolved “most authoritatively” by the Supreme Court of Delaware through the certified questions. Finally, similar proposals to the Proposed Bylaw have been subject to no-action requests in the past, and any future requests to exclude similar proposals will be affected by a resolution of the certified questions.

Pursuant to the Delaware certification requirements, the SEC articulated two “important and urgent reasons for an immediate determination” by the Court of the certified questions.

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42 SEC Certification, supra note 38, at 3-4, ¶¶(3)(a)-(d).
43 SEC Certification, supra note 38, at 3, ¶(3)(a); see also Del. Sup. Ct. R. 41(b) (“the following illustrate reasons for accepting certification: . . . (iii) Unsettled question. – The question of law relates to the constitutionality, construction or application of a statute of [Delaware] which has not been, but should be, settled by the Court.”).
44 SEC Certification, supra note 38, at 3, ¶(3)(b).
45 SEC Certification, supra note 38, at 3, ¶(3)(c). Note, however, that the Commission prefaced this reason with its position that “the Division determines in the first instance the application of Rule 14a-8 in any particular case.” Id. at 3, ¶(3)(a).
46 SEC Certification, supra note 38, at 3-4, ¶(3)(d); see also id. at 4, ¶(3)(d):
In at least one instance, the Division determined that the company was required to include the proposal in its proxy materials because the Division had received conflicting opinion from Delaware counsel on Delaware law, and the Division was unable to conclude that the company had met its burden under Rule 14a-8(g) of demonstrating that it was entitled to exclude the proposal under Rule 14a-8.
AFSCME submitted a similar proxy reimbursement bylaw proposal to Citigroup, Inc., which requested no-action relief from the SEC, but, faced with conflicting opinions of Delaware counsel, was denied. See Citigroup, Inc., SEC No-Action Letter, 2006 WL 568681 (Mar. 2, 2006). Also, AFSCME submitted substantially the same bylaw as the Proposed Bylaw for inclusion in Dell Inc.’s 2008 proxy materials. See supra note 19.
47 See Del. Sup. Ct. R. 41(b) (“Requirements for accepting certification. – Certification will be accepted in the exercise of the discretion of the Court only where there exist important and urgent reasons for an immediate determination by this Court of the questions certified.”) (emphasis added).
First, a determination would resolve whether the Division would agree to CA’s intended exclusion of the Proposed Bylaw.\(^{49}\) If the Court left the issue of Delaware law unresolved then, despite not receiving an answer, the Division would deny CA’s request for no-action relief to exclude the Proposed Bylaw.\(^{50}\) Second, CA intended to file its proxy materials on or about July 17, 2008, which was less than three weeks away.\(^{51}\) The SEC expressed concern that if the Court’s resolution of the questions was “to be brought to bear meaningfully” on the issue, then the determination was required “reasonably in advance of July 17, 2008.”\(^{52}\)

D. The Certification Process and Resolution of Unsettled Questions of State Law in No-Action Requests

The Delaware certification procedure is an important new tool that provides the SEC with an opportunity to obtain resolution of unsettled questions of state law presented in no-action requests. In reviewing no-actions requests, the Division avoids resolving unsettled questions of

\(^{48}\) SEC Certification, supra note 38, at 4, ¶(4); see also Del. Supr. Ct. R. 41(b) (“A certificate shall state with particularity the important and urgent reasons for an immediate determination by this Court of the question certified.”).

\(^{49}\) SEC Certification, supra note 38, at 4, ¶(4)(a).

\(^{50}\) SEC Certification, supra note 38, at 4, ¶(4)(a). The Commission emphasized this point throughout the Certification, mentioning three times in its four page Certification, that without resolution of the certified questions the Division would deny CA’s no-action request. See id. at 2, ¶(1)h:

The Division, faced with two conflicting opinions on Delaware law from Delaware law firms, does not resolve disputed questions of Delaware law. If there is no way to obtain any such resolution, the Division intends to inform CA that it has not satisfied its burden of demonstrating that it may exclude the AFSCME Proposal under Rule 14a-8(i)(1) or Rule 14a-8(i)(2).

Id. at 3, ¶(3)(b):

If the unsettled questions of state law are not resolved before CA begins printing its proxy materials, the Division will inform CA that that Division is unable to concur in CA’s view that CA may exclude the AFSCME Proposal from its proxy materials for CA’s 2008 annual meeting of shareholders because CA will not have met its burden under Rule 14a-8(g) of demonstrating that CA is entitled to exclude the proposal under 14a-8.

Id. at 4, ¶(4)(a) (“If there is no such resolution [of the certified questions], then the Division will deny CA’s request for no-action relief to exclude the proposal from its proxy materials.”).

\(^{51}\) SEC Certification, supra note 38, at 4, ¶(2)(c).

\(^{52}\) SEC Certification, supra note 38, at 4, ¶(4)(b); see also Cartwright Letter, at 1 (“Because of the tight schedule for CA to mail its proxy materials, there is unusual urgency.”).
state law. Before the addition of such procedure, unsettled questions of state law presented by proposed shareholder bylaws went unresolved. The SEC’s recognition of the certification procedure’s power is exhibited by the focus placed on the unsettled question of law presented in the Proposed Bylaw, which was an impediment to a thorough resolution of CA’s no-action request.

As indicated by the SEC in its Certification request, if a question of state law remains unsettled, no-action relief will not be granted under Rule 14a-8(i)(1) or Rule 14a-8(i)(2). When faced with conflicting opinions of state law, the Division will not grant relief, finding the issuer had not met its burden of proof. As well, the Delaware courts are hesitant to resolve unsettled

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53 See Robert J. Haft & Michele H. Hudson, Analysis of Key SEC No-Action Letters: 2008-2009 Edition § 10:18 (2008) (“potential conflict between shareholder bylaw power and board management power, unresolved by court decisions, . . . has placed the SEC staff in the uncomfortable position of deciding these unresolved state law issues on an ad hoc basis in contests between proponents and companies, largely under [Rule 14a-8](i)(1) and (2).”).

54 See SEC Certification, supra note 38, at ¶(1)h (“The Division, faced with two conflicting opinions on [state] law from [that state’s] law firms, does not resolve disputed questions of [state] law.”);


This [Proposed Bylaw] raised interesting questions under the Delaware General Corporations Law . . . . The SEC staff received conflicting opinions from two well-known law firms who practice Delaware corporate law. So rather than, as we have done in years past, acceding to the proponent's position — to use a baseball analogy — with "tie goes to the runner" approach, this year we used our new ability to certify questions to the Delaware Supreme Court and it accepted.

See also discussion supra note 50 and accompanying text.

56 SEC Certification, supra note 38, at 4, ¶(3)(b); see Haft, supra note 53, at § 10:18 (“[I]f conflicting state law opinions are proffered by proponent and the company, the proposal is not excluded on grounds [14a-8(i)] (1) and (2). This staff position is based . . . on the ground that the company has the burden of establishing the basis for an exclusion.”); see, e.g., PLM Int'l, Inc., SEC No-Action Letter, 1997 WL 219918 (Apr. 28, 1997) (Staff “unable to conclude that Verizon has met its burden of establishing that [it] may exclude the proposal under” Rule 14a-8(i)(1) & (2)); Massey Energy Co., SEC No-Action Letter, 2004 WL 394109 (Mar. 1, 2004) (Staff “unable to conclude that Massey Energy has met its burden of establishing that the proposal would violate applicable state law”); Verizon Commc’ns, Inc., SEC No-Action Letter, 2004 WL 213377 (Feb. 2, 2004) (Staff “unable to conclude that Verizon has met its burden of establishing that [it] may exclude the proposal under” Rule 14a-8(i)(1) & (2));
issues of Delaware law presented by shareholder bylaw proposals, citing ripeness issues.\textsuperscript{58} Thus, even if the issuer attempts to settle a question of law in the Delaware courts, it may not achieve resolution given the contingent nature of a proposed bylaw.\textsuperscript{59} Therefore, whether a company seeks no-action relief from the SEC, or injunctive relief from the Delaware Chancery Court, an unsettled question of law would act as a guise for the proposed bylaw’s inclusion in a company’s proxy materials.

With the addition of the certification procedure, the SEC may now resolve such questions. The certification procedure is not automatic, and there is no guarantee that the SEC will certify all unsettled questions of Delaware law for resolution. However, as seen in the Commission’s certification in \textit{CA}, the fact the Division has considered similar issues in past no-action requests, or may again in the future, favor certification.\textsuperscript{60} Also, the response to the Commission’s certification in \textit{CA} suggests that future certifications will occur.\textsuperscript{61} The Director of the Division of Corporation Finance recently expressed excitement to have the certification procedure available for the SEC’s continuing use.\textsuperscript{62} The certification procedure facilitates the

\textsuperscript{58} See, e.g., Bebchuk v. CA, Inc., 902 A.2d 737 (Del. Ch. 2006) (finding issues presented by shareholder proposed bylaw that sought to limit board’s power to adopt poison pill of indefinite duration not yet ripe for consideration); General DataComm Indus., Inc. v. Wisconsin Investment Bd., 713 A.2d 818 (Del. Ch. 1999) (declining, on ripeness grounds, to rule on validity of shareholder proposed options re-pricing bylaw because the proposal may not be adopted).

\textsuperscript{59} See Bebchuk, 902 A.2d. at 742 (“Absent some kind of precommitment among the stockholders to vote for the bylaw, the court cannot possibly know whether the bylaw will be adopted at the annual meeting.”). The proposed bylaw in \textit{Bebchuk} was included in CA, Inc.’s 2006 proxy materials. CA, Inc., Form DEF 14A, at 43 (filed Aug. 9, 2006). The proposal was defeated, receiving roughly 232m for, and 247m votes against. CA, Inc., Form 10-Q, at 58 (filed Nov. 3, 2006).

\textsuperscript{60} See SEC Certification, supra note 38, at ¶(1)I & ¶(3)(d).

\textsuperscript{61} At the ABA Annual Meeting a few months following the \textit{CA} decision, SEC Chief Counsel and Associate Director, Division of Corporation Finance Thomas Kim was described as “effusive in his praise of the Delaware Supreme Court’s prompt and professional rendering of a scholarly opinion on an extremely expedited timetable, and he said that it provides an excellent precedent for the SEC to call upon Delaware’s High Court again in the future to address similar issues.” Delaware Corporate and Commercial Litigation Blog, “Update on Delaware v. Federal Competition for Control of Corporate Governance,” http://www.delawarelitigation.com/2008/08/articles/commentary/update-on-delaware-v-federal-competition-for-control-of-corporate-governance/ (Aug. 11, 2008).

\textsuperscript{62} See John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission at
relatively quick resolution of unsettled issues of Delaware law, and provides the Division with a basis for determining, on the merits of the request, whether no-action relief is appropriate.  

III. THE SUPREME COURT OF DELAWARE’S DECISION IN CA, INC. V. AFSCME EMPLOYEES PENSION PLAN

On Monday, July 1, 2008, the Supreme Court of Delaware, recognizing the “important and urgent reasons for an immediate determination,” exercised its discretion to accept the certified questions as submitted by the SEC, and set an expedited briefing and argument schedule. Despite facing the Fourth of July holiday weekend, the parties’ briefs were filed on Monday, July 7, 2008, and oral argument was held at 10 a.m. on Wednesday, July 9, 2008. After oral argument, the Court was equally diligent, and issued its decision eight days later on July 17, 2008. The Court answered both questions in the affirmative—the Proposed Bylaw was a proper subject for shareholder action, but would cause CA to violate Delaware law if adopted.

Eighth Annual Institute on Securities Regulation in Europe: A Contrast in EU and U.S. Provisions “Speech by SEC Staff: Corporation Finance in 2008–A Year of Progress (“This was obviously an important decision substantively, but it also was very important to us in terms of process, as it was the first time we had certified a question under the new procedure. We’re very excited to have this tool at our disposal, and look forward to using it further, as appropriate, in coming years.”).”

20 days passed between the SEC Certification (June 27, 2008), and the Delaware Supreme Court’s Answer (July 17, 2008). See CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 229 (Del. 2008). CA had to delay the filing of its definitive proxy materials by only one week. Compare CA No-Action Request, supra note 20, at 1 (“CA currently plans to file its definitive proxy statement . . . on or about July 17, 2008”) with CA, Inc., Form DEF 14A (filed July 24, 2008).


Order, supra note 64, at 4, ¶¶C-D. An .mp3 version of the oral argument is available on the Supreme Court of Delaware website at: http://courts.delaware.gov/Courts/Supreme%20Court/oral%20arguments/2008-07-09_329_2008_CA_v_AFSCME.MP3.

CA, 953 A.2d at 227. Note that the Court decided the questions, presented as issues of law, de novo. Id. at 231 (citing B.F. Rich & Co., Inc. v. Gray, 933 A.2d 1231, 1241 (Del. 2007)).

CA, 953 A.2d at 237.

CA, 953 A.2d at 240.

-16-
A. First Certified Question: Is the Proposed Bylaw A Proper Subject for Shareholder Action?

The Court answered the SEC’s first certified question in the affirmative finding the Proposed Bylaw a proper subject for shareholder action.\textsuperscript{70} The Court established a framework through which to analyze the Proposed Bylaw that explored the relationship between the shareholders’ bylaw power and the board’s power to manage the business and affairs of the corporation. The Court then examined the Proposed Bylaw mindful of the fact that shareholder bylaws may regulate the process of board decisions, but not mandate the decision itself.

i. Shareholders’ Section 109(a) Bylaw Proposal Power is Limited by the Board’s Section 141(a) Power to Manage the Corporation’s Business and Affairs

Before considering the Proposed Bylaw, itself, the Court constructed a framework through which to conduct its analysis. The Court understood the first certified question to present the more precise issue of whether shareholders may propose and enact a bylaw without the board of director’s agreement.\textsuperscript{71}

The first part of the framework affirms that the Section 109(a) of the Delaware General Corporation Law (“DGCL”) empowers both the company’s shareholders and board of directors to adopt, amend, or repeal bylaws.\textsuperscript{72} CA’s Certificate of Incorporation, pursuant to Section 109(a), confers power on its board of directors to adopt, amend or repeal bylaws.\textsuperscript{73} The shareholders and board of directors each hold the power to adopt, amend, or repeal

\textsuperscript{70} CA, 953 A.2d at 237.
\textsuperscript{71} CA, 953 A.2d at 231.
\textsuperscript{72} CA, 953 A.2d at 231. Section 109(a) states:

\begin{quote}
After a corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote . . . ; provided, however, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . . 8 Del. C. § 109(a).
\end{quote}

\textsuperscript{73} CA, Inc., Restated Certificate of Incorporation, art. SEVENTH, § (2) (Mar. 8, 2006) (“The original By Laws of the corporation shall be adopted by the incorporator. Thereafter, the power to make, alter, or repeal the By Laws, and to adopt any new By Law, except a By Law classifying directors for election for staggered term, shall be vested in the Board of Directors.”).
“independently and concurrently.” The language of Section 109(a) raises the issue—fundamental to the first certified question—of whether shareholders’ and the board of directors share coextensive power to adopt bylaws.

The second part of the framework establishes that shareholders’ power under Section 109(a) is “not coextensive with the board’s concurrent power” because it is limited by the board’s management power under Section 141(a). The Court determined that the DGCL did not allocate to the board and the shareholders the “identical, coextensive power” under Section 109(a). Though shareholders’ power under Section 109(a) is “legally sacrosanct”—the power cannot be limited, or eliminated, without shareholders’ consent, or by action of the Delaware legislature—Section 109(a) does not “exist in a vacuum.” It must be examined alongside the broad grant of managerial power to the board of directors in Section 141(a). The DGCL does not contain an analogous allocation of management power to shareholders. The Court found

74 CA, 953 A.2d at 231; see also 8 Del. C. § 109(a) (“The fact that such power [to adopt, amend or repeal bylaws] has been so conferred upon the directors . . . shall not divest the stockholders . . . of the power, nor limit their power to adopt, amend or repeal the bylaws.”).
75 CA, 953 A.2d at 232.
76 CA, 953 A.2d at 231. If, “[a]s a purely theoretical matter,” the power was coextensive, any proposed bylaw would be the “proper subject for either shareholder or board action, without distinction,” and “the first certified question would be easily answered.” Id.
77 CA, 953 A.2d at 232; see Hollinger Int’l, Inc. v. Black, 844 A.2d 1022, 1079 (“[T]here has been much scholarly debate about the extent to which bylaws can-consistent with the general grant of managerial authority to the board in § 141(a)-limit the scope of managerial freedom a board has . . . .”).
78 CA, 953 A.2d at 232. Section 141(a), in relevant part, states, “[t]he business and affairs of every corporation organized under this chapter 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); see 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, 1762 (2006) (“[Delaware law] invests corporate managers with a great deal of authority to pursue business strategies through diverse means, subject to a few important restraints.”). CA’s Certificate of Incorporation tracks Section 141(a)’s language and empowers CA’s board of directors to manage its business and affairs. See CA, Inc., Restated Certification of Incorporation, art. SEVENTH, § (1) (Mar. 8, 2006) (“[t]he management of the business and the conduct of the affairs of the corporation shall be vested in [CA’s] board of directors, subject to their fiduciary duties and applicable Delaware law.”).
79 CA, 953 A.2d at 232; see, e.g., McMullin v. Beran, 765 A.2d 910, 916 (Del. 2000) (“One of the fundamental principles of the Delaware General Corporation Law statute is that the business affairs of a corporation are managed by or under the direction of its board of directors.”); Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291–92 (Del. 1998) (“One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. [. . .] Section 141(a) . . . confers upon any newly elected board of directors full power to manage and direct the business and affairs of a Delaware
the principle “well-established” that shareholders “may not directly manage the business and affairs of the corporation.” Because board management power is a “cardinal precept” of the DGCL, Section 109 is not an “exception ... otherwise specified” in the DGCL to Section 141(a).

The final part of the framework is a two-step analysis to assess whether—in light of Section 141(a)’s limits on Section 109(a) bylaws—the Proposed Bylaw is the proper subject for shareholder action. The first step requires a determination of the “scope or reach” of shareholders’ power to adopt, amend, or repeal a corporation’s bylaws. The second step, then, is to decide whether the Proposed Bylaw “falls within that permissible scope.” When a bylaw seeks to limit director authority—such as the Proposed Bylaw—the Court finds the analysis to be an “elusively difficult task.” Previous attempts to locate the boundary between permissible and impermissible bylaws limiting director authority failed to present a “coherent analytical structure.” To aid in its analysis, the Court employed the “tools” of other DGCL provisions and germane Delaware judicial decisions.

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80 CA, 953 A.2d at 232 (citing Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (“A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.”) (other citations omitted); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (“[I]n the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality.”). 81 CA, 953 A.2d at 232 n.7. Further, shareholder bylaws under Section 109(a) must not be “inconsistent with the law,” including Section 141(a). Id. The court’s holding rejects some scholarly assertions that shareholders’ bylaw powers under Section 109 is an “exception ... otherwise specified” to a board’s managerial authority under Section 141(a). See Leonard Chazen, The Shareholder Rights By-Law: Giving Shareholders a Decisive Voice, CORP. GOVERNANCE ADVISOR, Jan./Feb. 1997, at 17.

82 CA, 953 A.2d at 232.
83 CA, 953 A.2d at 232.
84 CA, 953 A.2d at 232.
85 CA, 953 A.2d at 232.
86 CA, 953 A.2d at 232 (quoting Hamermesh, supra note 1, at 444).
87 CA, 953 A.2d at 232-33.
ii. Shareholder Bylaws May Establish or Regulate the Process for Board Decision-Making, But Not Mandate the Decision Itself

1. The Relationship Between DGCL Sections 109(b) & 102(b)(1)

Having established its framework for analysis of the first certified question, the Court examined two provisions of the DGCL–Sections 109(b) and 102(b)(1)–that form the basis of CA’s and AFSCME’s arguments. These provisions, respectively, outline what a bylaw and the certificate of incorporation may contain.

AFSCME, relying on Section 109(b), argued the Proposed Bylaw relates to the shareholders’ right to participate in the director election process, which “necessarily includes the right to nominate an opposing slate.” CA countered that Section 109(b) must be read in conjunction with Section 102(b)(1). The Proposed Bylaw, CA argued, would limit the board of director’s “substantive decision-making authority” regarding corporate expenditures, and, therefore, pursuant to Section 102(b)(1), may only appear in CA’s Certificate of Incorporation.

The Court rejected CA’s argument determining that if “taken to its logical extreme” would eliminate a shareholder’s right to adopt bylaws altogether. Bylaws outline rules and procedures for the board of directors and shareholders, which “could be said to limit the

88 8 Del. C. § 109(b) (“The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the right or powers of its stockholders, directors, officers or employees.”).
89 8 Del. C. § 102(b)(1):
(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
(1) Any 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 provision are not contrary to the laws of this State.
90 CA, 953 A.2d at 233.
91 CA, 953 A.2d at 233 (quoting Harrah’s Entm’t v. JCC Holding Co., 802 A.2d 294, 310 (Del. Ch. 2002)).
92 CA, 953 A.2d at 233.
93 CA, 953 A.2d at 234. CA made this argument with respect to the second certified question, but the Court “view[ed] the argument as also properly bearing upon the first question.” CA, 953 A.2d at 234 n.12.
94 CA, 953 A.2d at 234; see also id. (“Implicit in CA’s argument is the premise that any bylaw that in any respect might be viewed as limiting or restricting the power of the board of directors automatically falls outside the scope of permissible bylaws. That simply cannot be.”).
otherwise unlimited discretionary power of the board.”95 However, Section 109(a) “carves out an area of shareholder power . . . that is expressly inviolate” within which shareholders may adopt bylaws.96 Thus, the Court held, that the Proposed Bylaw limits the board of director’s management power “only begins, but cannot end, the analysis” of the first certified question.97

The key question the Court identified was “what is the scope of shareholder action that Section 109(b) permits yet does not improperly intrude upon the directors’ power to manage [the] corporation’s business and affairs under Section 141(a).”98 Though the Court could resolve the certified questions, they did not allow the Court “to articulate with doctrinal exactitude a bright line” between shareholder bylaws permitted by Section 109(b) and those precluded by Section 141(a).99 To answer the question, the Court concluded that the DGCL—one of the Court’s “tools” for analysis—was “only marginally helpful.”100 Prior decisions of the Court, as well as the Chancery Court, would be the proper “tool” to resolve the issue.101

2. Delaware Judicial Decisions Upholding Process-Oriented Bylaws

Beginning its analysis, the Court examined the “process-creating function of bylaws” to frame the issue of whether the Proposed Bylaw “establishes or regulates a process for substantive director decision-making” or whether it “mandates the decision itself.”102 The proper function of a bylaw is “to define process and procedures” for board decision making, not to mandate

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95 CA, 953 A.2d at 234.
96 CA, 953 A.2d at 234.
97 CA, 953 A.2d at 234.
98 CA, 953 A.2d at 234.
99 CA, 953 A.2d at 234. The Court emphasized its decision was “case specific” and not an “attempt to delineate the location of [a] bright line” between Sections 109 and 141(a). Id. at 234 n.14.
100 CA, 953 A.2d at 234.
101 CA, 953 A.2d at 234.
102 CA, 953 A.2d at 235.
“specific substantive business decisions.” The Court cited the Chancery Court for the principle that:

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 is taken . . . . [T]here is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized.

Several DGCL provisions serve as examples of the “procedural, process-oriented nature of bylaws.” It is these purely procedural bylaws that do not improperly intrude upon the board’s power to manage the business and affairs of the corporation under Section 141(a).

CA had argued that even a facially procedural bylaw could improperly encroach upon a board’s authority, and, thus, the Proposed Bylaw, by mandating reimbursement, would impinge upon the CA board’s discretionary power to manage. CA also asserted that mandating expenditure of corporate funds was “necessarily substantive” and outside the scope of Section 109(b).

The Court determined that CA had conflated two different arguments, which “although facially similar, are analytically distinct.” Impermissible intrusion upon the board’s authority

103 CA, 953 A.2d at 234-35.
104 CA, 953 A.2d at 235 (quoting Hollinger Int’l, Inc. v. Black, 844 A.2d 1022, 1078-79 (Del. Ch. 2004)) (emphasis added); see also Hollinger, 844 A.2d at 1080 n.136 (“Sections 109 and 141, taken in totality . . . , make clear that bylaws may pervasively and strictly regulate the process by which boards act . . . .”). In Hollinger, the Chancery Court found a shareholder bylaw amendment that disbanded a committee of the board was proper under Delaware law, but invalidated the same amendments as in equitable. Id. at 1080-81.
105 CA, 953 A.2d at 235; see, e.g., 8 Del. C. § 141(b) (bylaws setting number of directors and establishing board quorum and voting requirements); § 141(f) (bylaws precluding board action without meeting); § 211(a) & (b) (bylaws to establish date and location of annual stockholders meeting); § 211(d) (bylaws specifying the conditions for calling special stockholders meetings); § 216 (bylaws establishing stockholders meeting quorum and voting requirements); § 222 (bylaws regulating notice requirements for adjourned stockholders meetings).
106 CA, 953 A.2d at 235; see, e.g., Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985) (upholding shareholder bylaw requiring unanimous board of directors attendance and approval for any action, and unanimous ratification of board committee action).
107 CA, 953 A.2d at 236.
108 CA, 953 A.2d at 236.
109 CA, 953 A.2d at 236 n.19.
to manage and expend corporate funds is different than usurping the board’s discretion and ability to fulfill its fiduciary duties in any decision to reimburse.110 The first certified question addressed whether the Proposed Bylaw impermissibly intrudes upon the board’s authority by mandating expenditure of corporate funds.111

iii. The Proposed Bylaw Is a Proper Subject of Shareholder Action Because The Bylaw’s Intent and Effect Concerns Regulation of Director Election Process

Though the Proposed Bylaw was “couched as a command to reimburse,” and open to CA’s critique, the Court determined that “although relevant, is not dispositive of whether or not it is process-related.”112 If worded differently, to emphasize “shareholders’ entitlement to reimbursement, rather than upon the directors’ obligation to reimburse,” the Court reasoned the Proposed Bylaw’s process-oriented nature would be more apparent.113 Though the reimbursement component should not be ignored, a bylaw requiring expenditure does not, “for that reason alone, become automatically deprived of its process-related character.”114 The Court held that the process-related nature of a bylaw must be resolved “in light of its context and purpose.”115

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110 CA, 953 A.2d at 236 n.19.
111 CA, 953 A.2d at 236 n.19 (“Analytically, the first argument is relevant to the issue of whether the Bylaw is a proper subject for unilateral stockholder action, whereas the second argument more properly goes to the separate questions of whether the Bylaw, if enacted, would violate Delaware law.”).
112 CA, 953 A.2d at 236.
113 CA, 953 A.2d at 236 n.20. The Court explained

[T]he Bylaw could have been phrased more benignly, to provide that ‘[a] stockholder or group of stockholders . . . shall be entitled to reimbursement from the corporation for reasonable expenses . . . incurred in connection with nominating one or more candidates in a contested election of directors to the corporation’s board of directors in the following circumstances . . . ’

Id.

114 CA, 953 A.2d at 236; see also id. at 237 (“That the implementation of [a bylaw] would require the expenditure of corporate funds will not, in and of itself, make such a bylaw an improper subject matter for shareholder action.”). The Court provides a hypothetical example of a bylaw requiring all meetings of the board to occur in person at the corporation’s headquarters. Id. at 236. This bylaw “would be clearly process-related,” and within shareholders’ power to adopt, even though it requires the corporation to expend funds for the reimbursement of directors’ travel expenses. Id.
115 CA, 953 A.2d at 236-37.
The context of the Proposed Bylaw, the Court stated, was the “process for electing directors,” which is an issue that shareholders has a “legitimate and protected interest.” The purpose of the Proposed Bylaw was to “promote the integrity” of the election process by “facilitating the nomination” of candidates by shareholders. Though “infelicitously couched as a substantive-sounding mandate,” the Court determined the “intent and the effect” of the Proposed Bylaw was regulation of the director election process, and, thus, a proper subject for shareholder action.

The Proposed Bylaw would encourage nomination by shareholders through the promise of proxy expense reimbursement if one or more of their candidates are elected. Under the current system, only board-sponsored nominees are reimbursed, unless dissident candidates can replace a majority of the board. The Proposed Bylaw would facilitate shareholders exercise of their right to participate in the selection of candidates for director elections. A shareholder’s right to vote in a director election “is meaningless without the right to participate in selecting the

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116 CA, 953 A.2d at 237 (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 n.2 (Del. Ch.1988) (“Delaware courts have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights.”); see also Blasius, 564 A.2d at 659 (“[W]hen viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration[s] not present in any other context in which directors exercise delegated power.”); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1378 (Del. 1995); MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003); 8 Del. C. § 211 (authorizing a shareholder to petition the Court of Chancery to order a meeting of stockholders to elect directors where such a meeting has not been held for at least 13 months)).

117 CA, 953 A.2d at 237.

118 CA, 953 A.2d at 235-36.

119 CA, 953 A.2d at 237; see, e.g., Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675, 690 (2007) (“The problem of costs is exacerbated by the asymmetric treatment of challengers and incumbents by existing legal arrangements. Although challengers get no reimbursement in the event that they lose, incumbents can charge their full expenses to the company regardless of the outcome.”).

120 CA, 953 A.2d at 237; see Rosenfeld v. Fairchild Engine & Airplane Corp., 309 N.Y. 168, 173,128 N.E.2d 291, 293 (N.Y. 1955) (“When the directors act in good faith in a contest over policy, they have the right to incur reasonable and proper expenses for solicitation of proxies and in defense of their corporate policies, and are not obliged to sit idly by.”).

121 CA, 953 A.2d at 237.
contestants,” and, therefore, the nominating process is a “fundamental and outcome-determinative step in the election” of directors.\footnote{CA, 953 A.2d at 237 (citing Harrah’s Entm’t v. JCC Holding Co., 802 A.2d 294, 311 (Del. Ch. 2002)); see also id. (“To allow for voting while maintaining a closed selection process thus renders the former and empty exercise.”) (citation omitted).}

\section*{iv. The Court Will Likely Conclude Bylaws Outside The Context of the Director Election Process Infringe Upon The Board’s Power to Manage the Business and Affairs of the Corporation}

Finding that shareholders have the right to participate in candidate selection, and they may facilitate that right with a bylaw mandating reimbursement to encourage non-board-sponsored nominees, the Court answered the first certified question in the affirmative.\footnote{CA, 953 A.2d at 237.} However, outside the director election process or other procedural elements of corporate governance—for example, board meeting and voting requirements—the mandatory nature of a bylaw compelling expenditure of corporate funds would not be a proper subject of shareholder action. The examination of a bylaws intent and effect is a malleable standard that allows the Court to look past the mandatory nature of the bylaw and determine it to be process-based. The Court’s alternative phrasing of the Proposed Bylaw diminishes, but does not remove, the obligatory nature of the Bylaw, which the Court seemingly admits when recognizing its rephrasing is merely a shift in emphasis.\footnote{CA, 953 A.2d at 236 n.20 (“Although the \textit{substance} of the Bylaw would be \textit{no different}, the emphasis would be upon the shareholders’ entitlement to reimbursement, rather than upon the directors’ obligation to reimburse.”) (emphasis added).}

Examining the Proposed Bylaw, the Court looks past its mandatory nature of because it concerns the director election process. Though a mandate on the board, the Court rehabilitates, and eases any concern, with its answer to the second certified question requiring a fiduciary out.\footnote{See discussion \textit{infra} notes 158-162 and accompanying text.} Protecting a board’s ability to discharge its fiduciary duties is only needed when the

\begin{itemize}
  \item CA, 953 A.2d at 237 (citing Harrah’s Entm’t v. JCC Holding Co., 802 A.2d 294, 311 (Del. Ch. 2002)); see also id. (“To allow for voting while maintaining a closed selection process thus renders the former and empty exercise.”) (citation omitted).
  \item CA, 953 A.2d at 237.
  \item CA, 953 A.2d at 236 n.20 (“Although the \textit{substance} of the Bylaw would be \textit{no different}, the emphasis would be upon the shareholders’ entitlement to reimbursement, rather than upon the directors’ obligation to reimburse.”) (emphasis added).
  \item See discussion \textit{infra} notes 158-162 and accompanying text.
\end{itemize}
board undertakes substantive action. Similar concerns are not as acute when dealing with solely process-oriented bylaw requirements.

The Court does its best to focus on the procedural nature of the Proposed Bylaw, despite the fact that while it establishes a process, it is a process mandating action by the board. A process is established mandating a pre-ordained outcome. The Court treads along the line between substance and procedure, which, depending on the vantage point, could be one in the same. Establishing the backdrop of director elections was a key factor for the Court, without which there is less impetus to view a bylaw as procedural rather than mandating substance.

The Court permits the Proposed Bylaw because it affects the process of director elections, which are different in kind than normal, strictly business decisions. When examining shareholder bylaws, the Court will likely defer to shareholders on director elections issues because of the importance of the franchise as a control mechanism on directors and shareholders are on an equal level in terms of expertise. Applying the “intent and effect” analysis to non-director election related bylaws will be less flexible in determining them to be process-oriented, and, therefore, a valid exercise of shareholder power. The Court will likely not show the same deference to shareholder bylaws addressing traditional management issues that directors possess particular experience. The director election process involves concerns not present in normal management of the business and affairs of a corporation.

126 See Centaur Partners, IV v. Nat’l Intergroup, Inc., 582 A.2d 923, 927 (Del. 1990) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”).

127 See Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 n.2 (Del. Ch. 1988) (“Delaware courts have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights.”);

128 See Blasius, 564 A.2d at 659-60 (“[W]hen viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve considerations not present in any other context in which directors exercise delegated power.”) (emphasis added).
1. Is the Proposed Bylaw Now Excludable From CA’s Proxy Statement Under Rule 14a-8(i)(8)?

Though a proper subject for shareholder action, the Proposed Bylaw, and similar bylaws regarding director elections, may face exclusion from a company’s proxy statement under Rule 14a-8(i)(8). Potentially troublesome for shareholders, is the SEC’s permitted exclusion of shareholder proposals that would create a procedure requiring a company to include shareholders’ director nominees in the company’s proxy materials.\(^{129}\)

In late 2007, the SEC released a final rule amending Rule 14a-8(i)(8) relating to shareholder proposals and director elections.\(^{130}\) Rule 14a-8(i)(8) was amended to address the uncertainty as to the scope of the Rule raised by a recent decision by the United State Court of Appeals for the Second Circuit.\(^{131}\) The SEC clarified, and codified its longstanding position, that Rule 14a-8 is not the proper means by which to achieve a contested director election.\(^{132}\) Thus, shareholder proxy proposals that could result in a contested election, either immediately or in the

\(^{129}\) Shareholder Proposals Relating to the Election of Directors, Release No. 34-56914, 72 Fed. Reg. 70,450, 70,453 (Dec. 11, 2007) (to be codified at 17 C.F.R. Part 240) [hereinafter SEC Rule 14a-8 Amendment] (“Rule 14a-8(i)(8) permits exclusion of a proposal that would result in an immediate election contest . . . or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders’ director nominees in the company’s proxy materials for subsequent meetings.”) (emphasis added).


\(^{131}\) See Am. Federation of State, County & Municipal Emp. Pension Plan v. Am. Int’l Group, Inc., 462 F.3d 121, 128 (2d Cir. 2006) (finding the election exclusion is limited to proposals “used to oppose solicitations dealing with an identified board seat in an upcoming election and reject[ing] the somewhat broader interpretation that the election exclusion applies to shareholder proposals that would institute procedures making such election contests more likely”).

\(^{132}\) SEC Rule 14a-8 Amendment, supra note 130, at 70,453. The long-held position of the SEC was “Rule 14a-8 is not the proper means for conducting campaigns or effecting reforms in elections of that nature, since other proxy rules . . . are applicable thereto.” Id. at 70,451 (quoting SEC Release No. 34-12598, 41 Fed. Reg. 29,982 (July 7, 1976)).
future, fall within the Rule 14a-8(i)(8) exclusion. The Supreme Court of Delaware recognized the Proposed Bylaw’s potential to produce more contested director elections.

However, the SEC stated the key focus of the Rule 14a-8(i)(8) analysis is whether the contested elections would be governed by the SEC’s proxy rules. Under this reasoning, the Proposed Bylaw should not be excluded because any contested election would occur under the SEC’s proxy disclosure rules. Further, the SEC stated the amendment to Rule 14a-8(i)(8) did not affect other previous interpretations of the Rule—including the position that proposals for shareholder reimbursement may not be excluded under the Rule.

CA argued in its no-action letter that the Proposed Bylaw would, in effect, force CA to include a proposed short slate in the CA’s proxy materials. The Supreme Court of Delaware explicitly recognized that the context of the Proposed Bylaw was director elections, and its purpose was to facilitate shareholder nominations for contested director elections. The exclusion analysis will turn on how the SEC interprets and determines when a bylaw “requires” the company to include a slate of nominees in its proxy materials.

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133 SEC Rule 14a-8 Amendment, supra note 130, 70,451. If such shareholder proposal were permitted, it could result in shareholder director nominees appearing in a company’s proxy materials, allowing circumvention of the relevant disclosure rules for proxy contests. Id. at 70,450; see Rule 14a-3, 17 C.F.R. 240.14a-3 (Information to be Furnished to Security Holders); Rule 14a-12, 17 C.F.R. 240.14a-12 (Solicitation Before Furnishing a Proxy Statement); Schedule 14A, 17 C.F.R. 240.14a-101 (Information Required in Proxy Statement).

134 CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 237 (Del. 2008) (“The Bylaw would encourage the nomination of non-management board candidates by promising reimbursement . . . .”). AFSCME, in its supporting statement to the Proposed Bylaw, identified future contested director elections as a main purpose of the Bylaw. See McEntee Letter, supra note 10, at enclosure (“The unavailability of reimbursement for director election campaign expenses for so-called ‘short slates’ . . . contributes to the scarcity of such contests.”)

135 SEC Rule 14a-8 Amendment, supra note 130, at 70,453.

136 SEC Rule 14a-8 Amendment, supra note 130, at 70,454.

137 CA No-Action Request, supra note 20, at 5 (“In reality . . . the Proposal would create a substantial financial incentive for CA to include . . . future stockholder nominations in it proxy statement.”).

138 CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 237 (Del. 2008) (“The context of the Bylaw at issue here is the process for electing directors . . . . The purpose of the Bylaw is to promote the integrity of that electoral process by facilitating the nomination of director candidates by stockholders.”).
The SEC did not agree with CA that no-action relief under Rule 14a-8(i)(8) was proper for the Proposed Bylaw.\textsuperscript{139} However, the explicit recognition by the Supreme Court of Delaware that the Proposed Bylaw relates to the director election process, while not binding upon the SEC, may affect future analysis of similar bylaws under Rule 14a-8(i)(8). If the SEC agrees with CA’s argument, that the Proposed Bylaw, in effect, requires, or coerces, inclusion of dissident candidates, exclusion might be proper. The SEC itself, in its support for the Rule 14a-8(i)(8) exclusion, analyzes the effect of director election bylaws, and permits exclusion if the effect is to require inclusion of dissident candidates on a company’s proxy statement in circumvention of the proxy disclosure rules.\textsuperscript{140} A functional application of the director election exclusion could lead to the exclusion of bylaws, which are the proper subject of shareholder action under Delaware law, but, similar to the Proposed Bylaw, relate to the director election process.

B. Second Certified Question: Would the Proposed Bylaw Cause CA To Violate Delaware Law?

The Court answered the SEC’s second certified question in the affirmative finding the Proposed Bylaw, if adopted, would cause CA to violate Delaware law. In making this decision the Court examined whether the Proposed Bylaw violated any common law principle of Delaware law.\textsuperscript{141} Under at least one scenario, the Court concluded the Proposed Bylaw’s mandatory reimbursement of proxy expenses would cause CA’s board of directors to breach their fiduciary duties.\textsuperscript{142} Thus, the Proposed Bylaw—lacking a “fiduciary out” clause—violated the

\textsuperscript{139} CA, Inc., SEC No-Action Letter, 2008 WL 2568454, at *1 (June 27, 2008).
\textsuperscript{140} See SEC Rule 14a-8 Amendment, supra note 130, at 70,450 (“An interpretation of Rule 14a-8(i)(8) that resulted in the Rule being used as a means to include shareholder nominees in company proxy materials would, in effect, circumvent the other proxy rules designed to assure the integrity of director elections.”) (emphasis added).
\textsuperscript{141} CA, 953 A.2d at 238.
\textsuperscript{142} CA, 953 A.2d at 238.
principle against contractual arrangements that preclude directors from fully discharging their fiduciary duties by committing them to a set course of action.\textsuperscript{143}

A board may properly reimburse proxy expenses when the issues in the contested election are a “question of policy as distinguished from personnel or management.”\textsuperscript{144}

However, when a proxy contest is driven by “personally or petty concerns,” or to promote interests detrimental to the corporation, the Court determined a board’s fiduciary duties would “compel” denial of reimbursement.\textsuperscript{145} Before engaging in its analysis, the Court recognized the certified questions, by their nature, require a judgment as to the validity of the Proposed Bylaw in the abstract.\textsuperscript{146} As opposed to a challenge in the course of litigation involving specific facts—where the Court presumes validity and construes the Bylaw consistent with the law—\textsuperscript{147} the Court considered every possible situation in which the board might act pursuant to the Proposed Bylaw.\textsuperscript{148}

\textsuperscript{143} CA, 953 A.2d at 238.

\textsuperscript{144} CA, 953 A.2d at 240 (citing Hall v. Trans-Lux Daylight Picture Screen Corp., 171 A. 226, 227 (Del. Ch. 1934); \textit{see also} Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 345 (Del. 1983) (permitting reimbursement when proxy contest “was actually one involving substantive difference about corporation policy”). Reimbursement of proxy expenses in contests involving various issues of corporate policy have been upheld under Delaware law. \textit{See, e.g.}, Hibbert, 457 A.2d at 340 (involving policy of hiring full-time management and changing the role of the audit committee); Levin v. Metro-Goldwyn-Mayer, Inc., 264 F. Supp. 797, 802 n.7 (S.D.N.Y. 1967) (debating whether corporation should alter its dividend policy); Empire S. Gas Co. v. Gray, 46 A.2d 741, 745 (Del. Ch. 1946) (deciding to maintain corporate offices in a certain location); Hand v. Mo.-Kan. Pipe Line Co., 54 F. Supp. 649, 650 (D. Del. 1944) (resolving whether to pursue liquidation on terms offered by management); \textit{Trans-Lux}, 171 A. at 229 (determining whether to pursue corporate merger).

\textsuperscript{145} CA, 953 A.2d at 240. The Court provides the example of a shareholder group associated with a corporation’s competitor that nominates a short slate of directors whose election would grant them access to proprietary business information that could be shared with the competitor. \textit{Id.} at 240 n.34.

\textsuperscript{146} CA, 953 A.2d at 238 (“The certified questions, however, request a determination of the validity of the Bylaw in the abstract. Therefore, in response to the [certified] question, we must necessarily consider any possible circumstance under which a board of directors might be required to act.”).

\textsuperscript{147} \textit{See} Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985) (“The bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with law . . . .”); \textit{see also} Stroud v. Grace, 606 A.2d 75, 79 (Del. 1992) (“Delaware courts should exercise caution [before] invalidating corporate acts based upon hypothetical injuries . . . .”).

\textsuperscript{148} CA, 953 A.2d at 238.
1. The *Quickturn & QVC* Fiduciary Out Requirement

The Proposed Bylaw’s lack of a fiduciary out is analogous to provisions previously invalidated by the Supreme Court of Delaware that prevented, or required, board action. Such provisions, the Court stated, act to “impermissibly deprive any . . . board of both its statutory authority to manage the corporation under 8 Del. C. § 141(a) and its concomitant fiduciary duty pursuant to that statutory mandate.” The Court established in *QVC* that “[t]o 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.”

Similarly, in *Quickturn*, the Court held that any infringement upon directors’ fiduciary duties is prohibited because Section 141(a) “confers upon . . . [the] board of directors full power to manage and direct the business and affairs of a Delaware corporation.”

One difference between the Proposed Bylaw and the provisions invalidated in *QVC* and *Quickturn* is the party imposing the restrictions on the board of directors. In *QVC* and *Quickturn*, the board voluntarily imposed the restrictions, whereas, with the Proposed Bylaw, the restrictions would be imposed involuntarily on the board by CA’s shareholders. Despite this, the

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149 Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994) (invalidating merger agreement’s “no shop” provision that prevented target corporation directors from communicating with a competing bidder to obtain the greatest value for shareholders).


151 CA, 953 A.2d at 239 (citing *Quickturn*, 721 A.2d at 1291); *see also Quickturn*, 721 A.2d at 1291 (“One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation.”); *QVC*, 637 A.2d at 41-42 (“[The DGCL] and the decisions of this Court have repeatedly recognized the fundamental principle that the management of the business and affairs of a Delaware corporation is entrusted to its directors, who are the duly elected and authorized representatives of the stockholders.”).

152 CA, 953 A.2d at 238 (citing *QVC*, 637 A.2d at 51); *see also QVC*, 637 A.2d at 51 (“The No-Shop Provision could not validly define or limit the fiduciary duties of the Paramount directors . . . . [T]he Paramount directors could not contract away their fiduciary obligations.”).

153 *Quickturn*, 721 A.2d at 1292; *see also id.* (“The Delayed Redemption Provision, however, would prevent a newly elected board of directors from completely discharging its fundamental management duties to the corporation and its stockholders for six months.”).
Court found “the distinction is one without a difference.” The Proposed Bylaw is still an “internal governance contract” that would prevent the “directors from exercising their full managerial power in circumstances where their fiduciary duties would otherwise require them to deny reimbursement.” Though it would be CA’s shareholders, not its directors, placing the limits, the Court did not find this fact to “legally matter.”

AFSCME argued that applying the principles from QVC and Quickturn was inappropriate because the Proposed Bylaw would remove the decision regarding proxy expense reimbursement entirely from the board’s discretion. The Proposed Bylaw entirely relieves the board of its fiduciary duties, and, therefore, AFSCME asserts, does not preclude the exercise of such duties. The Court rejected AFSCME’s argument, finding it “more semantical than substantive,” given that AFSCME’s argument “concedes the very proposition that renders the Bylaws, as written, invalid.”

2. The Proposed Bylaw Would Cause CA to Violate Delaware Law Because the Bylaw Would Not Permit CA’s Board to Fully Discharge Its Fiduciary Duties

The possibility that the mandatory nature of the Proposed Bylaw would require CA’s board to act contrary to its fiduciary duties was, the Court found, “not far fetched.” Though the Proposed Bylaw permits discretion as to the amount of reimbursement—“reasonable” expenses—the Court held that “does not go far enough.” Nothing in the Proposed Bylaw

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154 CA, 953 A.2d at 239.
155 CA, 953 A.2d at 239; see also Grimes v. Donald, 673 A.2d 1207, 1214 (Del. 1996) (“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.’”) (quoting Abercrombie v. Davies, 123 A.2d 893, 899 (Del. Ch. 1956)) overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000).
156 CA, 953 A.2d at 239. Only if the Proposed Bylaw were adopted as an amendment to CA’s articles of incorporation would the distinction between the shareholders and directors matter. Id. (citing 8 Del. C. §§ 102(b)(1) & 242).
157 CA, 953 A.2d at 239.
158 CA, 953 A.2d at 239.
159 CA, 953 A.2d at 239.
160 CA, 953 A.2d at 240.
161 CA, 953 A.2d at 240.
reserves the full power to fulfill fiduciary duties to CA’s board in determining whether to grant proxy expense reimbursement in any given situation.\textsuperscript{162} Thus, without a fiduciary out, the Proposed Bylaw, if enacted, would violate Delaware law.\textsuperscript{163}

The presence of a fiduciary out would substantially impede the goals of AFSCME’s Proposed Bylaw. A board may decide that electing a short slate of directors would be disruptive to the corporation and prevent consensus-building in any decisionmaking.\textsuperscript{164} A short slate of directors is almost, by definition, disruptive to the board’s management of a corporation’s business and affairs.\textsuperscript{165} Without a majority, the dissident directors will merely act to impede actions based on consensus by the board. Further, if the dissident directors did advocate policies that were beneficial to the corporation as a whole, then running a full slate of directors with these policies would seem more appropriate.\textsuperscript{166} If it did, running a full slate, and obtaining board control would solve any reimbursement problem and enable implementation of corporate change.

\textsuperscript{162}CA, 953 A.2d at 240 (citing Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (“Although the fiduciary duty of a Delaware director is unremitting, the exact course of conduct that must be charted to properly discharge that responsibility will change in the specific context of the action the director is taking with regard to either the corporation or its shareholders.”)).

\textsuperscript{163}CA, 953 A.2d at 240. The Court presented two options for those who would change CA’s corporate governance scheme to permit the inclusion of the Proposed Bylaw: Amend CA’s Certificate of Incorporation, or seek recourse with the Delaware General Assembly. \textit{Id}. One commenter has already suggested a proposed change to the Section 141(a) in response to the CA decision. See Brett H. McDonnell, \textit{Bylaw Reforms For Delaware’s Corporation Law}, 33 DEL. J. CORP. L. 651, 669-69 (2008) (proposing, \textit{inter alia}, amendment to Section 141(a) permitting shareholder bylaw to limit board’s discretion to manage the business and affairs of the corporation).

\textsuperscript{164}See Strine, \textit{supra} note 79, at 1780 (“Short slates are oddments to the traditionalist. Boards make decisions collectively, almost invariably by consensus; individual directors do not make business decisions.”); \textit{id}. at 1768 (“[B]oards almost always work by consensus and it is therefore silly to hold a solitary director responsible for a company’s poor performance or lack of responsiveness to shareholder interests. . . . personalized campaigns will do little to improve firm governance but do much to discourage good director candidates from serving.”)

\textsuperscript{165}See, \textit{e.g.}, Lipton & Rosenblum, \textit{supra} note 130, at 82 (“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, \textit{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, \textit{Some Thoughts for Boards of Directors in 2006}, CORP. GOVERNANCE ADVISOR 4 (Jan.-Feb. 2006) (“A balkanized board is a dysfunctional board.”).

\textsuperscript{166}See Strine, \textit{supra} note 79, at 1768 (“[T]he traditionalist has little interest in initiatives that single out specific board members for defeat or embarrassment. . . . When a board has failed, the traditionalist thinks the board should be removed as a whole.”).
By the mere fact of running a short slate, the shareholder implicitly admits the policies he advocates will likely not appeal to a majority of shareholders. Thus, expending corporate funds to reimburse a shareholder who ran a short slate to further personal policies may be contrary to a board’s fiduciary duty.\footnote{See, e.g., JANA Master Fund, Ltd. v. CNET Networks, Inc., 954 A.2d 335, 345 n.59 (Del. Ch. 2008) (“[T]he 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 . . . .”) (quoting Melvin Aron Eisenberg, \textit{Access to the Corporate Proxy Machinery}, 83 \textit{HARV. L. REV.} 1489, 1493-94 (1970)).}

The board may take a broader view and decide that protecting the interests of all shareholders, not just a vocal institutional investor, compels denial of reimbursement.\footnote{See Strine, supra note 79, at 1766 (“[D]iversified investors are not interested in corporation becoming a therapy couch for politically-motivated institutional investors to vent their causes of the moment.”).} It is not clear that shareholder activism add value to a corporation.\footnote{See Roberta Romano, \textit{Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance}, 18 \textit{YALE J. ON REG.} 174, 177 (2001) (“The empirical studies suggest that [institutional investor activism] has an insignificant effect on targeted firms’ performance. Very few studies find evidence of a positive impact, and some even find a significant negative stock price effect from activism.”); see also Lisa F. Borstadt & Thomas J. Zvirlein, \textit{The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance}, 21 \textit{FIN. MGMT.} 22, 23 (1992) (“A dissident victory does not necessarily improve the long-term share price performance of the firm. A negative, but insignificant, drift in the abnormal returns is observed for this group of firms in the post-proxy period.”); David Ikenberry & Josef Lakonishok, \textit{Corporate Governance through the Proxy Contest: Evidence and Implications}, 66 \textit{J. BUS.} 405, 407 (1993) (“The performance of targeted firms following a contest is surprising . . . . [I]n proxy contests where dissidents obtain one or more seats, abnormal returns following resolution of the con-test are significantly negative. Two years following the contest, the cumulative abnormal return has declined by more than 20%.”).} Also, shareholders may be motivated by their own interests, not those of all shareholders, when making bylaw proposals.\footnote{See Iman Anabtawi, \textit{Some Skepticism About Increasing Shareholder Power}, 53 \textit{U.C.L.A. L. REV.} 561, 579-83 (2006) (analyzing divergent interests between short-term and long-term shareholders); Stephen M. Bainbridge, \textit{Director Primacy and Shareholder Disempowerment}, 119 \textit{HARV. L. REV.} 1735, 1754-55 (2006) (arguing institutional investors may use their position to achieve benefits not shared by the entire shareholder class).}

Any decision by a board of directors to deny reimbursement based on its fiduciary responsibilities would be judicially reviewable.\footnote{CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 240 n.35 (Del. 2008).} However, this review, as with any decision regarding reimbursement, would come well after a contested election. Any pre-election challenge to the board’s potential action would face ripeness issues. The Court is silent on the
applicable standard of review for a denial of reimbursement.\textsuperscript{172} A board’s decision to deny reimbursement will likely be granted the wide deference of the business judgment rule,\textsuperscript{173} and not the heightened standard of review under \textit{Blasius}, despite the relation of proxy reimbursement to the director election process.\textsuperscript{174}

The concerns present in \textit{Blasius}—a board interfering with the shareholder franchise \textit{ex ante} to the vote—are different than a denial of reimbursement compelled by a board’s fiduciary duties.\textsuperscript{175} Compelling justification is required only when the board acts with the \textit{primary purpose} to impede the shareholder franchise and deprive the shareholders of a fair opportunity to vote.\textsuperscript{176} If the heightened \textit{Blasius} standard was imposed, a board would practically have no choice but to approve any reimbursement even if denial of insurmountable would be prudent.\textsuperscript{177}

\textsuperscript{172} The Court is silent as to the proper the standard of review. It is worth noting that in the Court’s example of a situation where a board’s fiduciary duties would compel denial of reimbursement—a competitor nominating directors whose election would be used to steal confidential business information—the Court did not indicate a higher standard of review for the board’s actions was warranted. See CA, 953 A.2d at 240; see also discussion supra note 145.

\textsuperscript{173} See Sinclair Oil Corp. v. Levien, 290 A.2d 717, 720 (Del. 1971) (“A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.”); see also Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (“The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a).”) overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

\textsuperscript{174} Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (requiring a compelling justification for board acts taken primarily to interfere with shareholder franchise).

\textsuperscript{175} Compare \textit{Blasius}, 564 A.2d at 659, (“[M]atters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power.”) with CA, 953 A.2d at 240 (“[W]here the proxy contest is motivated by personal or petty concerns, or to promote interests that do not further, or are adverse to, those of the corporation . . . reimbursement [could] be denied altogether.”).

\textsuperscript{176} See Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) (“[T]he application of the ‘compelling justification’ standard set forth in \textit{Blasius} is appropriate only where the ‘primary purpose’ of the board’s action [is] to interfere with or impede exercise of the shareholder franchise, and the stockholders are not given a full and fair opportunity to vote.”) (internal quotation marks omitted); Stroud v. Grace, 606 A.2d 75, 92 (Del. 1992) (holding the \textit{Blasius} standard inappropriate because “it cannot be said that the ‘primary purpose’ of the board’s action was to interfere with or impede exercise of the shareholder franchise”); MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1128 (Del. Ch. 2003) (“[T]he deferential traditional business judgment rule standard is inappropriate when a board of directors acts for the \textit{primary} purpose of impeding or interfering with the effectiveness of a shareholder vote.”).

\textsuperscript{177} \textit{Williams}, 671 A.2d at 1376 (“\textit{Blasius’} burden of demonstrating a ‘compelling justification’ is quite onerous, and is therefore applied rarely.”).
A board exercising its fiduciary duties to all shareholders should not be precluded from discharging its duty by applying the high threshold of the *Blasius* standard.\textsuperscript{178}

The business judgment rule will afford wide deference to any board decision denying reimbursement. The requirement of a fiduciary out in the Proposed Bylaw, thus, neuters much of a shareholder’s incentive to nominate a short slate of directors. Even if one of the shareholder’s nominees is elected, reimbursement is far from guaranteed, given that a majority of the newly elected board must decide that the short slate—which has just challenged the same board deciding upon reimbursement—acted to benefit the corporation and was not motivated by personal or petty concerns.

IV. CONCLUSION

On the same day the Supreme Court of Delaware released its answers to the certified questions, July 17, 2008, the SEC Division of Corporation Finance responded to CA’s No-Action Request.\textsuperscript{179} The Division stated it would not recommend enforcement action to the Commission if CA omitted the Proposed Bylaw from its 2008 proxy materials because the Proposed Bylaw would cause CA to violate state law.\textsuperscript{180} CA filed its definitive proxy materials with the SEC on July 24, 2008\textsuperscript{181}—without the Proposed Bylaw—and held its 2008 annual shareholders meeting on September 9, 2008.\textsuperscript{182}

The SEC’s certification of unsettled questions of Delaware law and the Supreme Court of Delaware’s prompt resolution of the certified questions suggests that CA is just the beginning of

\textsuperscript{178} See In re MONY Group, Inc. S’holder Litig., 853 A.2d 661, 674 (Del. Ch. 2004) (“courts will apply the exacting *Blasius* standard sparingly, and only in circumstances in which self-interested or faithless fiduciaries act to deprive stockholders of a full and fair opportunity to participate in the matter and to thwart what appears to be the will of a majority of the stockholders.”); Stroud, 606 A.2d at 92 (declining to apply *Blasius* because “the factual predicate of unilateral board action intended to inequitably manipulate the corporate machinery [was] completely absent”).


\textsuperscript{181} See CA, Inc., Form DEF 14A (July 24, 2008); CA, Inc., Form DEFA14A (July 24, 2008).

\textsuperscript{182} See CA, Inc., Form DEF 14A, Proxy Statement, at 1 (July 24, 2008).
this process to resolve unsettled questions of Delaware law in no-action requests. The principles enunciated by the Court regarding the relationships between shareholder bylaws and a board’s power to manage the business and affairs of a corporation have established a framework to examine future bylaws presenting unsettled questions of Delaware law.

A. Shareholder Bylaw Proposals After CA, Inc. v. AFSCME Employees Pension Plan

When the principles in CA are applied outside the context of a bylaw affecting the process for director elections, or the mechanics of board action, to bylaws establishing a process that mandates other types of board action, the Court’s framework will deem these to be improper subjects of shareholder action. The restriction of permissible bylaws to the process for director elections is borne out by applying the Court’s reasoning to other shareholder bylaws that involved unsettled issues of Delaware law, but, prior to the amended Delaware certification procedure, went un-reviewed by Delaware courts. Two examples of bylaws that contain unsettled questions of Delaware law, and previously escaped review by a Delaware court, are: a bylaw requiring a shareholder vote on severance agreements with senior executives, and a bylaw limiting the board’s power to enact a poison pill of unlimited duration with shareholder ratification. Under the Court’s analysis, both bylaws would be improper. First, examining the “intent and effect” or “context and purpose” of the bylaws demonstrates they both seek to

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183 See discussion supra notes 61-62 of the SEC’s positive reaction to Delaware certification procedure and the resolution of the CA case.
184 See supra note 57.
185 The SEC, before the amended Delaware certification procedure, received a no-action request from Massey Energy Company regarding a bylaw requiring shareholder ratification of senior executive officer severance agreements with a total value exceeding 2.99 times the executive’s base salary. Massey Energy Co., SEC No-Action Letter, 2004 WL 394109 (Mar. 1, 2004); see also supra note 57. The SEC, after receiving conflicting opinions of Delaware law regarding the bylaw, was “unable to conclude that Massey Energy ha[d] met its burden of establishing that the proposal would violate applicable state law.” Id.; see also discussion supra notes 56-57 and accompanying text.
186 Lucian Bebchuk, see supra note 18, submitted a bylaw for inclusion in CA’s 2006 proxy materials that would cause any poison pill to expire after one year unless it received shareholder ratification. Bebchuk, v. CA, Inc., 902 A.2d 737, 738-39 (Del. Ch. 2006). The Delaware Chancery Court declined to review the merits of the bylaw due on ripeness grounds. Bebchuk, 902 A.2d at 744; see discussion supra note 58.
mandate the substance, not just the process, of board action. The executive compensation bylaw mandates and restricts the action of the board in setting compensation for top executives—an action that directly relates to the management of the business and affairs of the corporation. The poison pill redemption bylaw restricts a board’s ability to act in an area that relates to the heart of a corporation’s business and affairs—defensive measures against potential hostile takeovers. Second, both would need to permit a board to fully discharge its fiduciary duties, effectively neutering the bylaws of any mandate on board action.

The unique nature of the director election process weighs heavily in the Court’s analysis and justification blessing the Proposed Bylaw as the proper subject of shareholder action. The Proposed Bylaw established a process requiring mandatory reimbursement. Comparing the Court’s response to both certified questions evidences this tension. There is a concern about fiduciary duties only if there is a substantive aspect to the action required by the Proposed Bylaw. There is no mention in Frantz or Hollinger of a need to ensure that directors may fully discharge their fiduciary duties in such instances where their process of decision making is being related. Since the Proposed Bylaw relates to the election process, the Court appeared willing to permit some infringement upon a board’s power to manage the business and affairs of the corporation related to director elections, but with the requirement of a fiduciary out. Given the focus on the director election process, application of the Court’s analysis in the first certified question is likely limited to the shareholder bylaws that involve the director election process.

In CA, Inc. v. AFSCME Employees Pension Plan, the Supreme Court of Delaware addressed head on the relationship between a shareholder’s power to adopt a bylaw and a board

187 Compare CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 235-36 (Del. 2008) (“[E]ven though infelicitously couched as a substantive-sounding mandate to expend corporate funds, [the Bylaw] has both the intent and the effect of regulating the process of electing directors of CA.”) with id. at 240 (“[T]he Bylaw mandates reimbursement of election expenses in circumstances that a proper application of fiduciary principles could preclude.”).
of director’s power to manage the business and affairs of a corporation. The SEC’s use of the newly amended Delaware certification procedure led to a prompt resolution of questions that had previously escaped review. While not carving out a bright line, the Court established that a shareholder’s bylaw can regulate the process of director decision making, but not mandate the decision itself. As well, when acting pursuant to a bylaw, the board must be able to fully discharge its fiduciary duties. CA is the first step in the process of demarcating the boundaries between permissible shareholder bylaws and the board’s substantive power to manage the corporation. However, the Court’s analysis will likely limit the permissibility of future shareholder bylaws outside the director election process that encroach upon the board’s power to manage the business and affairs of a corporation.