

Election of Directors

Rejection of Offer to Resign Under a 'Plurality Plus' Policy Is Not Sufficient

By Robert S. Reder & Matthew A. Thiel

Plurality voting continues to be the default provision under the Delaware General Corporation Law ("DGCL") for corporations whose charter documents do not specify the percentage of votes required for the election of directors. Under plurality voting, in an uncontested election, those directors receiving any votes in favor of their election are elected so long as a quorum is present, no matter how many votes are withheld from their election.

In recent years, numerous corporations, often in response to pressure from activist shareholders who prefer a majority voting standard, which they view as more "democratic," have adopted the so-called "Pfizer-Style" or "Plurality Plus" corporate governance policy in connection with uncontested board elections. Under such a policy, if a particular board member does not receive the support of a majority of the votes cast (affirmative votes plus votes withheld) with respect to his or her election, then that board member — although technically elected under the corporation's charter documents — must submit his or her resignation to a committee of the board, consisting of independent directors. The committee then decides in its discretion, or recommends to the board, whether to accept or reject the resignation. Corporations appreciate the flexibility that these policies provide, in contrast to a strict majority voting provision

incorporated into their charter documents (which, among other things, could leave an unclassified board without sitting directors if none receive majority support and are forced to resign).

A CASE IN POINT

In *City of Westland Police and Fire Retirement System v. Axcelis Technologies, Inc.* (C.A. No. 4473-VCN (Del. Ch. June 30, 2008)), the Delaware Court of Chancery recently ruled that a board's refusal to accept a director's resignation in this context does not, in and of itself, constitute the "credible evidence of wrongdoing" necessary to support an effort by a shareholder under § 220 of the DGCL to gain access to the corporation's books and records. This decision may yield unintended consequences for elections of directors that corporations and their advisers need to consider.

BACKGROUND

In early Spring 2008, Axcelis Technologies, Inc. ("Axcelis" or the "Company"), a Delaware corporation specializing in the manufacture and sale of semiconductor equipment, twice rejected unsolicited takeover bids of \$5.20 and \$6.00 per share respectively from SHI, another semiconductor company. Following public announcement of these bids, Axcelis' market price climbed to \$5.45 per share. Though ostensibly open to negotiations with SHI, Axcelis refused to proceed until a non-disclosure agreement was in place between the companies. SHI apparently refused for several months to enter into such an agreement with Axcelis.

At Axcelis's annual shareholders meeting held in May 2008, three incumbent directors ran unopposed for re-election to the board. Although these

directors were re-elected under the plurality voting provision of Axcelis's bylaws, they did not receive a majority of the total votes cast because a large number of shareholders withheld their votes. In accordance with Axcelis's Plurality Plus policy, the three directors submitted their resignations to a committee of the full board. The board, citing: 1) the experience and knowledge of the three directors; 2) the fact that one or more of them served on key board committees; and 3) the importance of retaining the directors in light of the ongoing need to address SHI's unsolicited offer, decided (based on the committee's recommendation) not to accept the directors' resignations.

MARKET PRICE FALLS AND LAWSUIT FOLLOWS

Following the annual meeting, the Company entered into a non-disclosure agreement and commenced negotiations with SHI. In September, however, after further due diligence investigation, SHI put its offer on "hold." After Axcelis publicly announced this development, its market price fell to \$1.43 per share. In February of the following year, Axcelis failed to make a required debt payment under an indenture and was forced to sell its most valuable asset to SHI at a price reflecting a fraction of the valuation implicit in SHI's earlier offers. When this transaction was announced, Axcelis's share price fell even further, to \$0.41.

Disappointed with these developments, the City of Westland Police and Fire Retirement System, an Axcelis shareholder ("Plaintiff"), delivered a demand seeking inspection of the Company's books and records. The Company rejected this demand. In response, Plaintiff filed a complaint with the Court of Chancery

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under DGCL § 220. The complaint contended that Plaintiff, along with other shareholders disappointed with the board's handling of SHI's bid, had withheld their votes from the re-election of the three directors at the 2008 annual meeting in order to trigger the Company's Plurality Plus policy and, presumably, force the directors to resign. In Plaintiff's view, the board's failure to accept the resignations of the three directors, coupled with the board's handling of SHI's unsolicited bids, was motivated by a desire to entrench the three directors and the rest of the board in office. Such conduct, according to Plaintiff, provided a "credible basis" from which to infer potential wrongdoing, and therefore Plaintiff's desire to investigate this wrongdoing constituted a "proper purpose" under DGCL § 220 to gain access to the Company's books and records.

The Company, of course, disputed Plaintiff's characterization of the vote. Attributing the results at least in part to a "withhold" recommendation from Institutional Shareholder Services (now RiskMetrics) after the board failed to support a shareholder proposal to eliminate the classified board structure from its certificate of incorporation, the Company maintained that it had the right to deny access under DGCL § 220. The court, siding with *Axcelis*, dismissed Plaintiff's action after a one-day trial at which no witnesses testified.

THE COURT'S ANALYSIS

Under DGCL § 220, a shareholder of a Delaware corporation has a conditional right to inspect a corporation's books and records. To gain access, a shareholder bears the burden of demonstrating a "proper purpose" that is "reasonably related to such person's interest as a stockholder." Investigation of suspected wrongdoing on the part of management or a board of directors has long been recognized as a proper purpose, but in the court's words (citing *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del. 2006)), "a Section 220 demand made merely on the basis of suspicion or curiosity is insufficient." Instead, a shareholder must "present some evidence to suggest a credible basis from which [this court] can infer that mismanagement, waste, or wrongdoing may have occurred." The court characterized this standard as "the lowest possible burden of proof in

Delaware jurisprudence."

Turning to Plaintiff's accusation that the *Axcelis* board's conduct was motivated by a desire to entrench the directors in office, the court observed that "[o]nly the Plaintiff's bare accusations suggest such a motive, and mere accusations are insufficient" to support a DGCL § 220 claim. According to the court, rather than inappropriately entrenching the three board members, the board had acted within the confines of the Policy to effectuate "the results of a valid shareholder election The *Axcelis* By-laws provide for director election by plurality vote, and the interposition of the Board's discretionary review required by the Policy cannot change that fact simply because the shareholders who chose to withhold their votes wish it to be so." And, in a statement that will no doubt be cited by supporters of the SEC's proposed initiative to provide eligible shareholders access to company proxy materials for the purpose of nominating alternative director candidates, the court noted that if they intended to remove the three directors, the "shareholders would have been better served by supporting an alternative slate of directors in the May 2008 election. A poor strategic choice cannot be the basis of a Section 220 action."

'Exercise of Discretion'

Having dispensed with Plaintiff's entrenchment theory, the court next addressed Plaintiff's contention that "the Board's exercise of discretion under the Policy warrants heightened scrutiny and a suspicion of wrongdoing." The court also rejected this argument, noting that "Plaintiff's position would require this Court to accept the theory that mere shareholder reliance upon a board-enacted governance policy could effectively rewrite the voting provisions contained in a corporation's by-laws." In this regard, the court noted that "[i]f mere acting in accordance with the terms of a Pfizer-style policy is to be found credible evidence of wrongdoing, then its death knell has been rung" as boards would no doubt be reluctant to adopt or maintain such policies.

POTENTIAL CONSEQUENCES FOR PLURALITY VOTING

The *Axcelis* court intended that its ruling promote the continued vitality of Plurality Plus provisions. As noted above, the court was concerned

that granting Plaintiff access to the Company's books and records under the circumstances would discourage boards from implementing Plurality Plus or similar policies. The ruling may, however, have an unintended impact not foreseen by the court. Its denial of inspection rights to Plaintiff, accompanied by its finding that the Company's Plurality Plus governance policy did not trump the voting provisions contained in the Company's bylaws, could in turn lead corporate activists to seek adoption of actual majority voting provisions in corporate charter documents, rather than allowing corporate boards to retain the discretion afforded by Plurality Plus policies. If that were to be the case, the *Axcelis* decision could very well spark a whole new round of debate over majority voting standards and contribute to the demise of Plurality Plus provisions and plurality voting for directors in general.

CONCLUSION

The *Axcelis* decision demonstrates the continued reluctance of Delaware courts to allow plaintiffs to utilize DGCL § 220 as a means to troll for lawsuits against corporations. In the words of the court, "Plaintiff must point the Court to something other than a precipitous drop in stock price before Section 220 inspection rights may be granted. Otherwise, Delaware corporations would be universally subject to the very burdens Section 220 was carefully designed to protect against."

As noted above, the *Axcelis* court did not wish, by granting DGCL access rights to the disgruntled shareholders, to give corporate boards reason to eliminate their Plurality Plus provisions. Ironically, however, the decision may prompt shareholders to demand that plurality voting provisions be eliminated entirely in favor of a less flexible majority voting standard.

