

Director Primacy Upheld

By Francis G. X. Pileggi

A case decided by the Delaware Court of Chancery in July centered on the ability of a stockholder to appoint corporate officers. The board-centric approach to corporate law, referred to as “director-primacy,” was again endorsed by the Delaware court in *Gorman v. Salamone*. The case was related to a long-running dispute for control of Westech Capital Corp. and the proper composition of its board.

An Expedited Case

The company’s voting agreement sets forth how directors are elected and removed. One subsection stipulated that, if approved by the person who owned more than half of two classes of company stock, a director could be removed. John Gorman IV, Westech co-founder and a majority stockholder of both classes of stock, contended that the company’s bylaws allowed him to appoint directors of Westech. He went on to amend the bylaws to allow stockholders to remove and select the CEO.

The bylaws reserved one board seat for the CEO. Gorman, who was already on the board, wanted to remove CEO Gary Salamone, based on the amended bylaw. That removal effectively made available the board seat reserved for the CEO. Gorman proceeded to appoint himself CEO and then named a new board member to fill the seat that he had vacated. The case was presented to the Court of Chancery based on Section 225 of the Delaware General Corporation Law (DGCL), which allows the court to expedite cases involving a dispute about the proper composition of a board.

The key issue that the Chancery Court was called upon to decide was whether the amended bylaw was valid under Delaware law.

Substantive Business Decisions

The court began its analysis with the basic truism that DGCL section 141(a) establishes the bedrock principle of director primacy, first articulated by then University of California, Los Angeles



Law Prof. Stephen Bainbridge in a 2003 article published in the *Northwestern University Law Review* (Vol. 97, No. 2). This principle provides that the business and affairs of every corporation shall be managed by or under the direction of the board. To be valid, bylaw changes must be limited to procedural matters and may not usurp the substantive function of the board. The court determined that removing an individual from a corporate office is a substantive business decision, and thus, a board function. An effort by a stockholder to appoint officers directly would improperly intrude on the board’s authority to manage the corporation.

The court in *Gorman* explained that the appropriate method for removing a corporate officer would be for the stockholder to exercise his or her voting power to reconstitute the board. Then, by working with the board and its new appointees, the stockholder could propose to replace the CEO.

The court concluded that the bylaw amendment purporting to allow a majority stockholder to remove a corporate officer was of no effect. As a result, the dismissal of Salamone was reversed and his seat on the board was restored. In addition, board action taken without Salamone was deemed invalid, because it was not carried out by a majority of the board’s proper members.

The court did not address related issues that might arise in extraordinary circumstances, such as where shareholder intervention in the officer-designation process may be necessary, or where enabling provisions were included in the certificate of incorporation. Nor did the court address the related question of whether a bylaw could grant stockholders the ability to directly elect individuals to vacant corporate office positions. The court relied, in part, on scholarly support for its conclusion that corporate officers must be selected by the board, and absent a contract, serve at the pleasure of the board.

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