IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ELDON KLAASSEN, Plaintiff and Counterclaim-Defendant, v. ALLEGRO DEVELOPMENT CORPORATION, RAYMOND HOOD, GEORGE PATRICH SIMPKINS, JR., MICHAEL PEHL, and ROBERT FORLENZA, Defendants and Counterclaimants.	)	C.A. No. 8626-VCL

MEMORANDUM OPINION

Date Submitted: October 31, 2013
Date Decided: November 7, 2013

R. Judson Scaggs, Jr., Kevin M. Coen, Frank R. Martin, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; George Parker Young, Kelli Larsen Walter, HAYNES AND BOONE, LLP, Fort Worth, Texas; *Attorneys for Plaintiff and Counterclaim-Defendant Eldon Klaassen.*

Peter J. Walsh, Jr., Ryan T. Costa, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Van H. Beckwith, Jonathan R. Mureen, Jordan H. Flournoy, BAKER BOTTS L.L.P., Dallas, Texas; *Attorneys for Defendants/Counterclaimants Allegro Development Corporation, Raymond Hood, and George Patrich Simpkins, Jr.*

Lisa A. Schmidt, Jacob A. Werrett, Adrian D. Boddie, RICHARD LAYTON & FINGER, P.A., Wilmington, Delaware; Robert B. Lovett, Karen Burhans, COOLEY LLP, Boston, Massachusetts; *Attorneys for Defendants/Counterclaimants Michael Pehl and Robert Forlenza.*

LASTER, Vice Chancellor.

This court's post-trial memorandum opinion held that the doctrines of laches and acquiescence barred plaintiff Eldon Klaassen from challenging his removal as CEO of Allegro Development Corporation ("Allegro" or the "Company"). *Klaassen v. Allegro Dev. Corp.*, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013) (the "Opinion"). As a predicate to this holding, the Opinion reasoned that because Klaassen challenged his removal on equitable grounds, the defendants could raise equitable defenses to defeat his claims. Translated into corporate terms, the Opinion held that when the Allegro board of directors (the "Board") removed Klaassen, that action was at most voidable, not void. Based in part on these rulings, the Opinion determined that Raymond Hood is currently Allegro's CEO and that the Board comprises Michael Pehl and Robert Forlenza as Series A Directors, John Brown as the Common Director, and Klaassen and Hood as Remaining Directors, using the categories of directors that were defined in the Opinion.

The rulings in the Opinion were implemented in a final order dated October 18, 2013 (the "Final Order"). To give Klaassen an opportunity to seek a full or partial stay pending appeal, the Final Order provided that paragraphs 2-4 of a status quo order entered on June 25, 2013 (the "Status Quo Order") would remain in effect until November 8, 2013. Klaassen noticed an appeal, and the Supreme Court granted his motion to expedite. Klaassen has now moved for a stay pending appeal. This opinion grants his motion in part.

I. LEGAL ANALYSIS

A motion for a stay pending appeal is governed by Court of Chancery Rule 62(d), which provides that "[s]tays pending appeal . . . shall be governed by article IV, § 24 of

the Constitution of the State of Delaware and by the Rules of the Supreme Court." Ct. Ch. R. 62(d). Court of Chancery Rule 62(d) does not otherwise provide guidance on handling a motion to stay.

Article IV, § 24 of the Constitution of the State of Delaware requires adequate security for a stay pending appeal. Section 24 states: "Whenever a person . . . appeals or applies to the Supreme Court for a writ of error, such appeal or writ shall be no stay of proceedings in the court below unless the appellant or plaintiff in error shall give sufficient security" to satisfy the final judgment below if the appeal is unsuccessful. Article IV, § 24 does not address matters other than the need for security.

Supreme Court Rule 32(a) covers motions for stay in greater detail. It states:

> A motion for stay must be filed in the trial court in the first instance. The trial court retains jurisdiction over the initial motion and must rule on the initial motion regardless of whether the case is on appeal to this Court. A stay or an injunction pending appeal may be granted or denied in the discretion of the trial court, whose decision shall be reviewable by this Court. The trial court or this Court, as a condition of granting or continuing a stay or an injunction pending appeal, may impose such terms and conditions, in addition to the requirement of indemnity, as may appear appropriate in the circumstances.

Supr. Ct. R. 32(a). A motion to stay thus turns on the trial court's discretion.

In *Kirpat, Inc. v. Delaware Alcoholic Beverage Control Commission*, 741 A.2d 356 (Del. 1998), the Supreme Court identified four factors to guide a trial court when exercising its discretion under Rule 32(a). They are (1) "a preliminary assessment of likelihood of success on the merits of the appeal," (2) "whether the petitioner will suffer irreparable injury if the stay is not granted," (3) "whether any other interested party will suffer substantial harm if the stay is granted," and (4) "whether the public interest will be

harmed if the stay is granted." *Id.* at 357. The *Kirpat* factors are not a checklist; rather, the trial court must "consider all of the relevant factors together to determine where the appropriate balance should be struck." *Id.*

In *Kirpat*, the Supreme Court reversed the denial of a stay pending appeal because the trial court focused too narrowly on the first factor, "a preliminary assessment of likelihood of success on the merits of the appeal." *Id.* As *Kirpat* explained, this element "cannot be interpreted literally or in a vacuum when analyzing a motion for stay pending appeal." *Id.* at 358. In an appeal from a final judgment, the trial court has already issued a decision in the case, so a literal reading "would lead most probably to consistent denials of stay motions . . . because the trial court would be required first to confess error in its ruling before it could issue a stay." *Id.* (internal quotation marks omitted). Instead, "[i]f the other three factors strongly favor interim relief, then a court may exercise its discretion to reach an equitable resolution by granting a stay if the petitioner has presented a serious legal question that raises a fair ground for litigation and thus for more deliberative investigation." *Id.* (internal quotation marks omitted). Informed by *Kirpat*, this decision analyzes the second, third, and fourth factors, then returns to the first.

A. Whether The Petitioner Will Suffer Irreparable Injury Without A Stay

The second *Kirpat* factor is "whether the petitioner will suffer irreparable injury if the stay is not granted." 741 A.2d at 357. Because of the nature of Klaassen's claims, there is a risk that Klaassen will suffer irreparable injury without a stay.

Klaassen brought this litigation pursuant to Section 225 of the Delaware General Corporation Law (the "DGCL"), 8 *Del. C.* § 225, after he purported to change the

composition of the Board. Klaassen's ability to do so turned in part on whether he remained CEO. The outcome of this litigation, therefore, will determine who has the authority under Section 141(a) of the DGCL to direct and oversee the business and affairs of Allegro. *See* 8 *Del. C.* § 141(a). The Final Order established a Board that includes individuals who Klaassen does not believe should be directors. If Klaassen prevails on appeal, then the Board will comprise different directors.

"[I]t has become customary in § 225 actions to put into place, either by agreement of the parties or court order, a *status quo* arrangement that precludes the directors presently in control of the corporation from engaging in transactions outside the ordinary course of the corporation's business until the control issue is resolved." *Arbitrium (Cayman Is.) Handels AG v. Johnson*, 1994 WL 586828, at *3 (Del. Ch. Sept. 23, 1994). This custom derives from the recognition that "the exercise of corporate power by one group or the other always risks being the exercise of power by an unauthorized party, . . . [a]nd it is that risk, the risk that an unauthorized party will ultimately have power over corporate assets and processes, that is the risk that justifies some reasonable restrictions." *Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm'cns Corp.*, C.A. No. 12150, at 27-28 (Del. Ch. July 9, 1991) (Allen, C.) (TRANSCRIPT). Consistent with *Arbitrium* and *Credit Lyonnais*, this court entered the Status Quo Order at the outset of the case.

The same risk of unauthorized Board action that undergirded the entry of the Status Quo Order supports finding a threat of irreparable harm for purposes of the second *Kirpat* factor. It is entirely possible that the Supreme Court could reverse the Opinion and vacate the Final Order. If so, and if the Board installed by the Final Order is not

restricted in the interim by some form of stay, then there might well be a variety of actions and decisions that Klaassen or other Allegro stockholders could challenge. If the unauthorized actions could not be unwound or remedied, then irreparable injury would result. Consequently, there is a threat of irreparable injury if a stay is not granted.

B. Whether Any Other Interested Party Will Suffer Substantial Harm If The Stay Is Granted

The third *Kirpat* factor is "whether any other interested party will suffer substantial harm if the stay is granted." 741 A.2d at 357. The defendants contend that a further stay will harm Allegro by interfering with its rapidly improving business. Hood asserts that "Allegro is currently performing above expectations and has achieved year-to-date revenue of 7% over the 2013 budget and is poised to register greater than 25% growth over 2012—it's [sic] fastest growth in 5 years." Hood Aff. ¶ 3. Forlenza adds that "[a]s of September 30, 2013, Allegro is over 3 million dollars ahead of plan for revenue, 1.3 million dollars ahead of plan for EBITDA, and is forecasting year end revenue growth of 26% and EBITDA growth of 66% over 2012." Forlenza Aff. ¶ 4. According to the defendants, granting a stay of the Final Order pending appeal will impair Allegro's ability to continue along its upward trajectory.

The defendants' position reduces to an argument that if there is a stay, then Allegro will not be able to achieve as much as it otherwise would. They do not contend that Allegro's progress will reverse itself. Therefore, the defendants have not shown that Allegro or other parties will suffer substantial harm from a stay. Their concerns can best be addressed by tailoring the stay narrowly.

C. Whether The Public Interest Will Be Harmed If The Stay Is Granted

The fourth *Kirpat* factor is "whether the public interest will be harmed if the stay is granted." 741 A.2d at 357. Allegro is a privately held company that provides software for energy trading and risk management. Who controls the Board of Allegro is critically important to the litigants, and the outcome will affect the lives of the Company's employees and the fortunes of its suppliers and customers. Those interests, however, are private interests of particular corporate constituencies. To the extent they affect the outcome of Klaassen's motion, they weigh in favor of a stay to ensure that the wrong Board does not take unauthorized actions with implications for those constituencies

D. The Appeal Presents Serious Legal Questions

Taken together, the second, third, and fourth factors all support some form of stay pending appeal. Under *Kirpat*, therefore, the operative question is whether Klaassen has presented a serious legal question that raises a fair ground for appeal. 741 A.2d at 357. Klaassen's appeal meets that standard.

1. Klaassen's Super-Director Theory

Klaassen has stated that he plans to argue on appeal that the Opinion erred by crediting affirmative defenses to validate a void act, which he claims a court of equity cannot do. *See STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1137 (Del. 1991); *Waggoner v. Laster*, 581 A.2d 1127, 1137 (Del. 1990). According to Klaassen, the Board's actions were void, even if the steps taken complied in all respects with the DGCL, the Charter, and the Bylaws, and even if the directors fulfilled their fiduciary duties. In making this argument, Klaassen relies on four decisions from this court that

supposedly recognize a special equitable notice requirement that benefits any individual who is (i) both an officer and a director and (ii) can exercise a right that could alter the composition of the board.[1] Klaassen reads these cases to say that a board of directors cannot terminate such an officer without first providing advance notice of the board's plans sufficient to enable the officer to preempt the board by changing its composition. Under this reading, such an officer becomes a super-director whose powers trump the board's statutory authority under Section 141(a).

Klaassen contends that he fits the super-director paradigm. He was Allegro's CEO and a director, he held sufficient common stock to allow him to vote a majority of the Company's outstanding voting power, and he enjoyed contract rights in his capacity as CEO to designate two outside directors. In his view, therefore, the Board could not terminate him unless the directors first provided him with sufficient notice so that he could preempt the Board by changing its composition. Klaassen asserts that his termination was void because the Board did not respect his special equitable notice right and permit him to exercise his hybrid superpowers.

A review of Klaassen's four decisions reveals tensions with prior case law and, more critically, with Delaware's director-centric system of corporate governance.[2] As

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[1] In support of this theory, Klaassen cites *Koch v. Stearn,* 1992 WL 181717 (Del. Ch. July 28, 1992), *vacated as moot*, 628 A.2d 44, 46-47 (Del. 1993); *VGS, Inc. v. Castiel,* 2000 WL 1277372 (Del. Ch. Aug. 31, 2000), *aff'd*, 781 A.2d 696 (Del. 2001) (ORDER); *Adlerstein v. Wertheimer,* 2002 WL 205684 (Del. Ch. Jan. 25, 2002), and *Fogel v. U.S. Energy Sys., Inc.*, 2007 WL 4438978 (Del. Ch. Dec. 13, 2007).

[2] *See* 8 *Del. C.* § 141(a) ("The business and affairs of every [Delaware corporation] shall be managed by or under the direction of a board of directors . . . ."); *accord, e.g.*, *McMullin v.*

will be seen, however, the cases do present serious legal questions for appeal.

a. Pre-*Koch* Case Law

Assessing the seriousness of Klaassen's super-director argument requires an understanding of how Delaware case law in this area has developed. The Delaware courts first addressed the importance of a director receiving advance notice of board meetings in *Lippman v. Kehoe Stenograph Co.*, 95 A. 895 (Del. Ch. 1915). There, a director who had not received notice of the corporation's initial board meeting and who did not attend the meeting challenged actions taken at the meeting. This court wrote:

> It is, of course, fundamental that a special meeting held without due notice to all the directors is not lawful, and all acts done at such meeting are void. As to regular, or stated, meetings the rule is different. Presence at the meeting waives the notice, and so may a waiver be properly executed before the meeting, for there is still an opportunity to attend it.

Id. at 898 (citation omitted). The *Lippman* decision thus distinguished between special meetings, where advance notice was required, and regular meetings, where advance

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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 corporation.") (citations omitted); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 41-42 (Del. 1994) ("The General Corporation Law of the State of Delaware . . . and the decisions of [the Delaware Supreme] 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."); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1154 (Del. 1989) ("Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board representatives."); *see also CA, Inc. v. AFSCME Empls. Pension Plan*, 953 A.2d 227, 232 (Del. 2008) (holding that stockholders' statutorily mandated authority to amend bylaws is "not coextensive with the board's concurrent power and is limited by the board's management prerogatives under Section 141(a)").

notice was not necessary. Klaassen was terminated at a regular meeting, not a special meeting.

Equally important for purposes of Klaassen's appeal is the policy rational that *Lippman* cited for the notice requirement:

> The reason and principle underlying these decisions is this: Each member of a corporate body has the right to consultation with the others and has the right to be heard upon all questions considered, and it is presumed that if the absent members had been present they might have dissented and their arguments might have convinced the majority of the unwisdom of their proposed action, and thus have produced a different result. If, however, they had notice and failed to attend they waived their rights; likewise if they signed a waiver of notice prior to the meeting . . . .

Id. at 899 (citation omitted). The problem with failing to provide advance notice of a special board meeting in the manner required by the bylaws is that a director who does not receive notice cannot attend and participate in his capacity as a director: "Discretionary powers, questions of policy, business administration, all imply the personal attendance at the meeting, so that each director may have the benefit of not only the vote, but the voice of every other director, or at least of enough other directors to constitute a quorum." *Id.*; *see also In re Acadia Dairies, Inc.*, 135 A. 846, 847 (Del. Ch. 1927) (Wolcott, C.) (noting that a director cannot act *qua* director by proxy); *Lippman*, 95 A. at 897 (explaining that the reason a director cannot act by proxy is that "his associates are entitled to his judgment, experience and business ability, just as his associates cannot deprive him of his rights and powers as director").

In two subsequent decisions involving notice of special board meetings, this court followed *Lippman* and held director action invalid when taken at a special board meeting

for which notice had not been given in the manner required by the bylaws. *See In re Seminole Oil & Gas Corp.*, 1958 WL 55434, at *1 (Del. Ch. July 30, 1958) (holding board resolution passed at special meeting invalid because one director did not receive notice of the meeting and "[a]ll the directors were entitled to notice thereof"); *Bruch v. Nat'l Guar. Credit Corp.*, 116 A. 738, 740 (Del. Ch. 1922) ("Unless notice be given to each director of a special meeting of the board of directors as required by the by-laws, the meeting is illegal and action taken thereat is not binding."). Neither decision altered or elaborated on the rule or its underlying rationale, instead treating those matters as settled law.

The next development in Delaware's notice jurisprudence came in *Schroder v. Scotten, Dillon Co.*, 299 A.2d 431 (Del. Ch. 1972). In considering the sufficiency of notice for a special board meeting, the court, for the first time in Delaware, went beyond testing for strict compliance with the bylaws to consider the equities of the situation. The *Schroder* case involved the validity of actions taken at two purported board meetings. For a special board meeting ostensibly held on December 13, 1971, notice had not been given to one member of the board who failed to attend. This situation presented a straightforward application of the *Lippman* rule: "A special meeting held without due notice to all directors as required by the by-laws is not lawful and all acts done at such a meeting are void." *Id.* at 435 (citing *Bruch* and *Lippman*).

The second situation, however, did not fit under the *Lippman* rule. As to the special meeting purportedly held on December 23, 1971, the same member of the board claimed not to have received notice, but the court found that "if he did not, it was only

because he refused to accept the two registered letters by which notice was sent." *Id.* at 436. Rejecting the director's position, the court held that "[o]ne cannot wilfully avoid receiving notice and then claim that he had none." *Id.* But the same director also asserted that the Chairman told him the meeting would be postponed until December 29 and that he relied on that representation in failing to attend. The Chairman did not dispute this account, and the court held that the director's absence was obtained by the Chairman's representation that the meeting would not be held. *Id.* This finding in turn was sufficient to invalidate the action taken at the December 23 meeting:

> A quorum obtained by trickery is invalid, and the reasoning which forbids trickery in securing a quorum applies equally well to securing the absence of opposing directors from a meeting by representing that such a meeting will not be held. I therefore conclude that actions taken at the special directors meeting of December 23, 1971 were void and the officers and directors of the company remained unchanged after that meeting.

Id. (citation omitted). Notably, the trickery in *Schroder* prevented the director from attending the special board meeting. The analysis in *Schroder* thus comported with the rationale set out in *Lippman*: Each member of the board has the right to participate in deliberations and consult with his fellow directors, and trickery cannot be permitted to deprive the non-attending director of that right.

The Court of Chancery next took up the question of the sufficiency of notice for a special board meeting in *Pepsi-Cola Bottling Co. v. Woodlawn Canners, Inc.*, 1983 WL 18017 (Del. Ch. Mar. 14, 1983). In that case, each stockholder in a bottling cooperative organized as a Delaware corporation had agreed that the corporation could repurchase any stockholder's shares if that stockholder failed to purchase at least two-thirds of its

soda requirements from the cooperative. One of the stockholders, Pepsi Cincinnati, had secured an alternative source of supply and would benefit if the cooperative stopped supplying soda in its territory. The remaining stockholders preferred the existing arrangement. Over the course of three board meetings, it became clear that Pepsi Cincinnati did not plan to meet its purchasing requirement and hoped to alter the cooperative's commercial arrangement. To head off Pepsi Cincinnati, the president of the cooperative called an impromptu special board meeting on April 25, 1980, the day of the annual meeting of stockholders, as the bylaws indisputably empowered him to do. Because it was the date for the annual meeting of stockholders, all directors were present. Realizing that the other directors intended to cause the cooperative to repurchase Pepsi Cincinnati's shares, the Pepsi Cincinnati representative objected and left the meeting. The remaining directors voted 3-1 to cause the corporation to repurchase Pepsi Cincinnati's shares. *Id.* at *4-7.

In the ensuing litigation, Pepsi Cincinnati challenged the effectiveness of the repurchase by contesting the validity of the special board meeting. *Id.* at *12. This court noted that the special meeting was called in compliance with the cooperative's bylaws, which authorized the president to call and conduct board meetings and did not require advance notice for any director actually present at the meeting. *Id.* Citing *Schroder* and *Trendley v. Ill. Traction Co.*, 145 S.W. 1 (Mo. 1912), Pepsi Cincinnati argued that the presence of its director-representative was obtained by trickery, claiming that the director had been "lured into attendance because of the noticed shareholders meeting." *Id.* The court rejected this argument:

> I do not find Pepsi Cincinnati's authorities to be applicable to this situation. Both *Schroder* and *Trendley* turn on the inability of the duped director to participate meaningfully in the board's deliberations even though neither had the power to change the result. In *Schroder* the director was falsely told that the meeting had been rescheduled and thus he missed it. In *Trendley*, the director was in his office doing his daily work when other directors [unexpectedly] barged in so as to force a meeting at which they would constitute a majority. In the one case the director was not able to participate and in the other he was not prepared to do so.
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> Here, Welch was present and could have participated had he chosen to remain. Secondly, he was accompanied by an official of his parent company and two attorneys for the company. . . . He was clearly familiar with the divergent viewpoints . . . . And he was certainly familiar with the workings of Woodlawn and its needs since he had been its president for five years and a director since its formation.
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> In short, there is nothing to indicate that Welch was placed under any disadvantage by the impromptu calling of the special meeting . . . . In fact, there is every reason to believe that in all probability he was prepared to discuss the very things that were covered at the special meeting . . . .

Id. at *12-13. Although the court recognized that it had the power to invalidate the meeting in equity, it found "no basis to declare the meeting illegal . . . simply because Welch had no advance notice," at least where there was "no invalidating trickery in calling the special meeting at a time when all directors were present" and were capable of addressing the issues raised. *Id.* at *13.

b. *Koch*

Nine years after *Pepsi-Cola*, the *Koch* decision took a very different approach to advance notice for special board meetings. Klaassen relies on *Koch* as the cornerstone of his super-director rule.

The company at issue in *Koch*—Showcase Communications Network, Ltd. ("Showcase")—had four directors: Stearn, Koch, Bunn, and Ginsberg. Stearn was the

company's President and CEO and also controlled a majority of the corporation's outstanding voting power. Koch was an outside director who owned Series A Preferred Stock that gave him the right to elect a fifth director if certain covenants were breached. Bunn was described as Koch's designee and Ginsberg as Stearn's designee, but the source of the designation right is unclear. *See Koch*, 1992 WL 181717, at *2. Showcase had not yet begun generating revenues, and by February 1992 it was apparent to all the directors that the company was running out of funds. Stearn obtained an offer from Ira Shapiro, a third party, to provide $250,000 in interim financing secured by a first position lien on all of Showcase's assets. Koch offered to invest $2 million subject to certain conditions, including that Stearn resign as President and CEO and that the offer be accepted by April 2. On March 31, the directors met and discussed the offers, including the possibility of Stearn resigning. Bunn and Ginsberg endorsed Koch's offer, but no formal action was taken. Stearn then allowed Koch's deadline to pass without responding.

On April 6, 1992, Bunn faxed a letter to Showcase's attorney asking that he and Stearn attend a special board meeting the following morning. The letter stated that the meeting was necessary in light of the Shapiro offer and the "dire financial condition of Showcase." *Id.* at *3. Later that day, Bunn sent Koch and Ginsberg draft resolutions that included Stearn's removal as President and CEO. The draft resolutions were not sent to Stearn.

During the special board meeting on April 7, 1992, Bunn asked Stearn whether he had reconsidered Koch's offer. When Stearn said no, Bunn proposed a resolution to

remove Stearn as President and CEO and replace him with Ginsberg. Koch seconded the motion, and Koch, Bunn, and Ginsberg voted in favor. At some point, Stearn stated that he wanted to remove Ginsberg but was told by Bunn that he would have to deliver a stockholder written consent for that action to take effect. Koch purported to exercise his power to elect a fifth director.

Koch and his fellow directors brought suit pursuant to Section 225 of the DGCL to confirm the validity of their actions. The court upheld Koch's election of a third director but invalidated Stearn's removal as President and CEO. The decision summarized the existing law as follows:

> The validity of the board action taken on April 7th . . . depends upon whether Stearn was tricked or deceived into attending the meeting. If so, the general rule is that actions taken at such a meeting are void. Notwithstanding any deceit that may have been involved in calling a meeting, the actions taken will not be invalidated where the deceived director remains at the meeting and participates throughout, or where that director suffers no disadvantage in his ability to participate meaningfully in the meeting.

Id. at *4 (internal citations omitted). The court recognized that Stearn likely had some reason to suspect that his termination would be discussed and was capable of addressing the issue, but nevertheless held that "he was tricked into attending the meeting." *Id.* at *5. This was because the letter calling the special meeting "suggested that the board would be considering the revised Shapiro offer" but was "silent as to any possible consideration of the Koch offer, which had technically expired." *Id.* The court also noted that "the outside directors had an agenda, which included removing Stearn from office if he did not cooperate and step down voluntarily." *Id.*

In reaching this conclusion, *Koch* departed from prior precedent in three significant ways. First, the decision approached trickery differently. As demonstrated most clearly by the *Pepsi-Cola* opinion, earlier cases required trickery sufficient to cause a director not to attend a meeting at all or to be caught wholly unprepared for an important decision. *See Pepsi-Cola*, 1983 WL 18017, at *12-13; *cf. Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 679 (Del. 2013) (distinguishing between silence and "fraud or trickery" that affirmatively misleads another). In *Koch*, Stearn received notice of the special board meeting, knew the gravity of the subjects to be discussed (the company's "dire financial condition" and the Shapiro offer), and had reason suspect that his termination would be considered. *Koch*, 1992 WL 181717, at *5 ("I agree that Stearn may have had some reason to suspect that his removal from office would be discussed on April 7th (as it was on March 31st) . . . ."). He chose to attend the meeting and participated in the deliberations on multiple issues. Nevertheless, the court held that trickery had occurred. *Id.*

Second, *Koch* evaluated participation differently from prior precedent. The *Koch* decision found that Stearn "did not vote or otherwise participate in the meeting after the resolution calling for his removal from office was presented." *Id.* Earlier cases, such as *Pepsi-Cola*, evaluated whether the director was capable of participating in the meeting based on his familiarity with the issues being addressed, rather than examining whether the director chose to vote or speak. *See Pepsi-Cola*, 1983 WL 18017, at *12-13. Stearn had the ability to discuss his own performance, and both he and company counsel objected to the proposal to remove him. *Koch*, 1992 WL 181717, at *4. After the vote

on removal, the meeting continued, and Stearn expressed his desire to remove Ginsberg and engaged in discussion about the Shapiro proposal. *Id.* Yet the *Koch* decision held that Stearn had not participated for purposes of determining the validity of actions taken at the meeting. Viewed on a broader level, *Pepsi-Cola* and earlier cases seem to have presumed that directors are informed and can participate in board-level discussion, with the burden on the objecting director to show that he was unable to participate. *Koch* seems to have taken the opposite approach and given Stearn the benefit of the doubt when he chose not to engage in discussion about his removal or vote on the resolution.

Third, the *Koch* decision broke from precedent when considering whether Stearn was disadvantaged. The opinion analyzed the issue as follows:

> If Stearn had seen the draft resolutions before the meeting, he could have exercised his right to remove Ginsberg as a director and he could have replaced Ginsberg with another nominee who would vote with Stearn to block Stearn's removal. Without doubt, Stearn's inability to thus protect himself constituted a disadvantage. Thus, I conclude that the actions taken at the April 7th board meeting were void and of no effect.

Id. at *5. From *Lippman* through *Pepsi-Cola*, Delaware precedents had analyzed disadvantage in terms of a director's ability to discuss the matters raised during the meeting. The cases found a disadvantage when the director lacked the ability to engage, either because he was deceived into not attending or because the issue raised was entirely new and unanticipated. None of the precedents considered disadvantage in terms of rights held in other capacities, such as stockholder voting rights, nor did they frame the concept in terms of the individual's ability to affect the board's composition and preempt the board's decision. In taking this analytical turn, the *Koch* decision did not discuss the

resulting tension between an equitable requirement of prior notice that would enable a CEO-director to preempt a board decision and the bedrock statutory principle of director primacy established by Section 141(a) of the DGCL. Nor did the *Koch* decision address any potential issues of entrenchment raised by the CEO's removal of an independent director to protect the CEO's incumbency.

Stearn appealed the holding that Koch validly appointed a fifth director, and Koch cross-appealed the validity of Stearn's termination as President and CEO. *See Stearn v. Koch*, 628 A.2d 44 (Del. 1993). While the appeals were pending, Stearn resigned. Upon learning of this event, the Supreme Court asked whether the cross-appeal was moot. After the parties briefed the issue, the Supreme Court held that the appeal was moot. *Id.* at 46 ("Clearly, there is no actual controversy remaining between the parties about whether Stearn has been validly removed as President and Chief Executive Officer of Showcase."). The Supreme Court then analyzed whether the trial court opinion should be vacated. *Id.* After determining that "it would be contrary to the interests of justice to allow the judgment of the Court of Chancery to have any precedential or preclusive *res judicata* effect against Koch and Showcase," the Supreme Court remanded the case to the Court of Chancery with instructions to vacate the portion of its decision that addressed the validity of Stearn's removal as President and CEO. *Id.* at 47. In response to Stearn's motion for reargument, the Supreme Court confirmed its decision to vacate the Court of Chancery's decision, holding that even if Stearn only resigned from the board and not as an officer, as he claimed, he also voluntarily dismissed his appeal challenging the appointment of the fifth director, ending any dispute over the validity of that action. This

concession prevented Stearn from contesting the board's later decision to remove him as President and CEO by a 3-2 vote, again rendering the appeal moot and necessitating vacatur. *Id.* at 47-48.

Under federal law, a vacated decision lacks precedential effect. *See O'Connor v. Donaldson*, 422 U.S. 563, 577 n.12 (1975) ("Of necessity our decision vacating the judgment of the Court of Appeals deprives that court's opinion of precedential effect . . . ."); *accord In re Bernard L. Madoff Inv. Sec. LLC*, 721 F.3d 54, 68-69 (2d Cir. 2013) ("[V]acatur dissipates precedential force."). Delaware's law of vacatur generally tracks the federal approach. *See Tyson Foods, Inc. v. Aetos Corp.*, 818 A.2d 145, 148 (Del. 2003) (noting that "the vacatur standard set forth in *Stearn* is drawn entirely from federal precedent" and that the federal vacatur standard is in "harmony with Delaware's standard"). Consistent with the Supreme Court's statement in *Koch* that the Court of Chancery decision there would have no further precedential effect, the Supreme Court more recently explained that "[v]acating a judgment annuls the judgment and, to the extent indicated, invalidates the ruling that supports the judgment" and that "[a] vacated decision has no force and effect." *Pauley ex rel. Pauley v. Reinoehl*, 848 A.2d 561, 566 (Del. 2003). Ironically, the *Pauley* opinion was itself partially vacated on reargument, but not with respect to its holding on vacatur. *See Pauley ex rel. Pauley v. Reinoehl*, 848 A.2d 569 (Del. 2004). Subsequent trial court decisions have followed *Koch* as precedential without discussing its departures from prior cases or the Supreme Court's decision to vacate it.

The Supreme Court has never had the opportunity to rule on the significant

analytical moves in *Koch* or consider the tension between the equitable advance notice right for the CEO and the structural premise of Section 141(a). It is nevertheless possible that the Supreme Court could find *Koch* persuasive and embrace it fully or in part. The case consequently presents fair questions for further litigation on appeal.

c. *VGS*

The second advance notice decision on which Klaassen relies is *VGS*. That case involved an LLC, not a corporation, and the trial court stressed that it reached its holdings "under the unique circumstances of this case and the structure of this LLC Agreement." *VGS*, 2000 WL 1277372, at *5. The Supreme Court has since cautioned that "LLCs and corporations are different; investors can choose to invest in an LLC, which offers one bundle of rights, or in a corporation, which offers an entirely separate bundle of rights." *CML V, LLC v. Bax*, 28 A.3d 1037, 1043 (Del. 2011). The Supreme Court also has stressed that "in the LLC context specifically, the General Assembly has espoused its clear intent to allow interested parties to define the contours of their relationships with each other to the maximum extent possible." *Id.* The nature of the entity and the structure of the LLC agreement likely explain certain elements of the *VGS* decision that do not translate easily to the corporate context.

The LLC at issue was Virtual Geosatellite LLC (the "LLC"), a company that hoped to capitalize on an FCC license to build and operate a satellite system. Through Virtual Geosatellite Holdings, Inc. ("Holdings") and Ellipso, Inc., David Castiel controlled 75% the LLC's member interests and an equal percentage of its outstanding voting power. Holdings was a holding company, and Ellipso was an operating business

also engaged in the satellite field. A third entity, Sahagen Satellite Technology Group LLC ("Sahagen Satellite") owned the remaining 25% of the LLC's member interests, exercised an equal percentage of its voting power, had the right to block certain transactions, and could appoint a single member of the LLC's three member board of managers. "Peter Sahagen, an aggressive and apparently successful venture capitalist, control[led] Sahagen Satellite." *VGS*, 2000 WL 1277372, at *1. Sahagen appointed himself to the board. Castiel elected himself and an individual named Quinn. *Id.*

Castiel and Sahagen soon disagreed over how to manage the LLC. Over time, Sahagen came to believe that Castiel was a poor manager and that the LLC's "mission had become untracked, additional necessary capital could not be raised, and competent managers could not be attracted to join the enterprise." *Id.* at *2. Sahagen also believed that Castiel was using the LLC to support Ellipso. *Id.* Eventually, Sahagen decided that for the LLC to prosper, Castiel needed to be removed from management, and he convinced Quinn of that fact. At trial, "[m]any LLC employees and even some of Castiel's lieutenants testified that they believed it to be in the LLC's best interest to take control from Castiel." *Id.*

The LLC's operating agreement authorized a majority of the board of managers to act by non-unanimous written consent. To achieve the goal of removing Castiel from management, Sahagen and Quinn executed a written consent causing the LLC to merge with and into a new Delaware corporation. As part of the transaction, Sahagen invested $10 million in the post-transaction entity and received equity in return. The merger reversed Castiel and Sahagen's equity ownership stakes. Before the merger, Castiel

owned 75% and Sahagen owned 25% of the LLC. After the merger, Castiel owned 37.5% of the corporation and Sahagen owned 62.5%. The directors of the post-merger corporation were Sahagen and Quinn.

Even though neither the LLC agreement nor the Delaware Limited Liability Company Act required notice to Castiel, the *VGS* court held that Sahagen and Quinn owed fiduciary duties to Castiel that included giving him advance notice of their plan. In reaching this conclusion, the court read the LLC agreement as giving Castiel the right to appoint and remove two managers, thereby "guaranteeing control over a three member board." *Id.* at *4. The court also construed the agreement as causing Sahagen and Quinn's duty of loyalty to run to Castiel personally as the majority interest holder. *See id.* ("[T]hey failed to discharge their duty of loyalty *to him* in good faith.") (emphasis added). Because of the structure of the LLC agreement, the court held that Sahagen and Quinn "owed Castiel a duty to give him prior notice even if he would have interfered with a plan that they conscientiously believed to be in the best interest of the LLC." *Id.* Elsewhere, the decision noted that if Castiel had known of the plan in advance, "Castiel surely would have attempted to replace Quinn with someone loyal to Castiel who would agree with his views." *Id.* at *2. The court held that Sahagen and Quinn breached their duty of loyalty to Castiel by "launch[ing] a preemptive strike that furtively converted Castiel's controlling interest in the LLC to a minority interest in VGS without affording Castiel a level playing field on which to defend his interest." *Id.* at *4.

The two principal building blocks of the *VGS* analysis would create dissonance if applied to a corporation. First, corporate directors do not owe fiduciary duties to

individual stockholders; they owe fiduciary duties to the entity and to the stockholders as a whole. *See, e.g.*, *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) ("[C]orporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."); *eBay Domestic Hldgs., Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010) (explaining that directors' fiduciary duties include "acting to promote the value of the corporation for the benefit of its stockholders"). This is true even if a single stockholder holds a controlling block. Equity will protect a controlling stockholder against the dilution of its position when a board acts for an improper purpose, such as entrenchment, that is adverse to the interests of the entity and all of its stockholders,[3] but a board otherwise does not have a duty to protect the controller. The board's fiduciary duty of loyalty compels the directors to act in the best interests of the entity and the stockholders as a whole, and a board acting loyally may take action to oppose, constrain, or even dilute a large or controlling stockholder.[4] "Where . . . a board of directors acts in

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[3] *See Mendel v. Carroll*, 651 A.2d 297, 304 (Del. Ch. 1994) (Allen, C.) (discussing *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769 (Del. Ch. 1967) and *Can. S. Oils, Ltd. v. Manabi Exploration Co.*, 96 A.2d 810 (Del. Ch. 1953)); *Phillips v. Insituform of N. Am., Inc.*, 1987 WL 16285, at *8 (Del. Ch. Aug. 27, 1987) (Allen, C.) (same); *see also Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 810 (explaining that outside of the electoral context, directors can pursue a course of action contrary to the wishes of a stockholder majority if they satisfy enhanced scrutiny); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659-62 (Del. Ch. 1988) (Allen, C.) (recognizing that board can, consistent with its fiduciary duties, take action that interferes with a stockholder majority given a sufficiently compelling justification).

[4] *See, e.g.*, *Hollinger Int'l, Inc. v. Black (Hollinger I)*, 844 A.2d 1022, 1088 (Del. Ch. 2004) (approving board's deployment of rights plan to prevent controlling stockholder from selling block of shares to third party), *aff'd*, 872 A.2d 559 (Del. 2005); *Mendel*, 651 A.2d at 307 ("I continue to hold open the possibility that a situation might arise in which a board could, consistently with its fiduciary duties, issue a dilutive option in order to protect the corporation or its minority shareholders from exploitation by a controlling shareholder who was in the process

good faith and on the reasonable belief that a controlling shareholder is abusing its power and is exploiting or threatening to exploit the vulnerability of minority shareholders, . . . the board might permissibly take such an action." *Mendel*, 651 A.2d at 304.

Second, in the corporate context, the fact that a stockholder appoints or elects a majority of the directors does not entitle the stockholder to control the board. In *Aronson*, the Supreme Court held that a stockholder's ownership of 47% of a corporation's outstanding stock, which gave the stockholder the effective ability to elect all of the directors, did not give the stockholder the power to control the board so as to undermine the directors' independence. *Aronson v. Lewis*, 473 A.2d 805, 815-16 (Del. 1984).[5] Delaware decisions consistently reject the related concept of "constituency directors" as well as the notion that a director appointed by a particular minority stockholder or a particular class or series of stock can or should serve the particular

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or threatening to violate his fiduciary duties to the corporation . . . ."); *Blasius*, 564 A.2d at 662 n.5 (suggesting hypothetical that could support dilutive action); *Phillips*, 1987 WL 16285 at *7 ("[*Unocal*] teaches that the powers of the board to deal with perceived threats to the corporation extend, in special circumstances, to threats posed by shareholders themselves and a board may, in such circumstances, take action to protect the corporation even if such action discriminates against and injures the shareholder or class of shareholders that poses a special threat."); *see also La. Mun. Police Empls.' Ret. Sys. v. Fertitta*, 2009 WL 2263406, at *8 (Del. Ch. July 28, 2009) (declining to dismiss claim that board breached its fiduciary duties by failing to employ a rights plan to block a creeping acquisition by a large and arguably controlling stockholder when considered "together with other suspect conduct").

[5] In *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), the Supreme Court overruled seven precedents, including *Aronson*, to the extent those precedents reviewed a Rule 23.1 decision by the Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *See id.* at 253 n.13. The *Brehm* decision held that, going forward, appellate review of a Rule 23.1 determination would be *de novo* and plenary. *Brehm*, 746 A.2d at 253-54. The *Aronson* decision otherwise remains authoritative.

interests of the appointing entity. *See generally* E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors,* 63 Bus. Law. 761 (2008) (summarizing Delaware case law).

There is consequently significant tension between traditional principles of corporate law and the reasoning in *VGS* to the effect that the LLC's managers owed a duty of loyalty to Castiel *qua* majority interest holder and that Castiel had a right under the LLC agreement to control the board. Each suggests that the *VGS* decision relied on unique features of an entity-specific LLC agreement. Not surprisingly, the *VGS* court carefully restricted its decision to "the unique circumstances of this case and the structure of this LLC Agreement." 2000 WL 1277372, at *5.

Klaassen relies heavily on *VGS* and stresses the fact that in its order summarily affirming the decision on appeal, the Supreme Court stated that "to the extent that the issues raised on appeal are legal, they are controlled by settled Delaware law, which was properly applied." *VGS, Inc. v. Castiel*, 781 A.2d 696 (Del. 2001) (ORDER). There are consequently fair questions for further litigation over the implications of *VGS*.

d. *Adlerstein*

The next advance notice decision on which Klaassen relies is *Adlerstein*. At first blush, it appears to be a strong precedent for Klaassen, but closer analysis reveals that the *Adlerstein* opinion questioned the source of the super-director concept and appeared troubled by the implications of *VGS* for the corporate realm. The court ultimately followed *Koch*, but without recognizing that *Koch* lacked precedential value or noting the tensions between *Koch* and earlier case law.

Adlerstein concerned the validity of actions taken during a special meeting on July 9, 2001, by the board of directors of SpectruMedix Corporation. Adlerstein was a scientist and entrepreneur who founded SpectruMedix and who also served as its President and CEO. SpectruMedix went public in 1997, then raised additional capital in 1999 by issuing Series A Preferred Stock. Later in 1999, Adlerstein loaned SpectruMedix $500,000 in return for a note convertible into Series B Preferred Stock that carried 80,000 votes per share. He subsequently converted the note, which resulted in his controlling 73.25% of the company's outstanding voting power while owning 21.41% of its equity.

In 2000, the SpectruMedix board consisted of Adlerstein and two outsiders: Mencher, a money manager; and Wertheimer, an investment banker. During that year, the company's financial condition deteriorated quickly. In March 2001, Adlerstein was hit with a sexual harassment complaint, and an internal investigation found that he was guilty and had been less than candid during the investigation. In April 2001, an outside financial consultant projected that the company's cash balance would drop to crisis levels by May 31. At a board meeting on April 30, Mencher and Wertheimer expressed concern about the company's cash position. Adlerstein dismissed their concerns and suggested that the company had always found money before and would do so again. The divergence of opinion persisted during a meeting on May 25. At the meeting, the board resolved to hire a restructuring consultant, but Adlerstein interfered with the consultant's work. Wertheimer then contacted three of the company's four department heads and learned they were planning to quit if the restructuring consultant's recommendations

were not implemented. The consultant advised Wertheimer and Mencher that Adlerstein was "the central problem" and that "[f]or SpectruMedix to have any chance, [Adlerstein] must be removed." *Adlerstein*, 2002 WL 205684, at *4.

To address the looming crisis, Wertheimer contacted Ira Reich, who had both the personal wealth and managerial acumen to restructure SpectruMedix. Wertheimer believed Reich was the only person who might be able to save the company. On June 28, 2001, Reich met with Adlerstein. After the meeting, Reich concluded that he only would invest if Adlerstein resigned. Reich subsequently signed a confidentiality agreement with SpectruMedix and began to conduct due diligence. Adlerstein interfered with these efforts.

On July 2, 2001, Wertheimer, Mencher, and Reich discussed a potential investment and the possibility of firing Adlerstein for cause. Adlerstein did not know about their meeting. At the time, SpectruMedix was either insolvent or operating on the brink of insolvency, Adlerstein was not communicating with creditors, and key vendors were refusing to make deliveries. SpectruMedix lacked sufficient cash on hand to meet its next payroll, and the company's auditors were unwilling to issue the opinion letter necessary for the company to file its annual report with the SEC.

On July 5, 2001, Wertheimer asked Adlerstein to attend a special board meeting on July 9. The court found that

> Adlerstein was aware that the topics to be discussed at the meeting would be (i) SpectruMedix's dire financial condition and immediate need for cash, (ii) [a pending] arbitration, including the need to retain new counsel, (iii) the formal execution of an agreement to retain [the restructuring

> consultant], and (iv) the Company's certified public accountants' refusal to issue an audit opinion.

Id. at *5. In advance of the meeting, Reich made a formal proposal to invest in the company, and Wertheimer, Mencher, and Reich held a teleconference during which they discussed the investment and terminating Adlerstein. The deal documents were circulated in draft form by July 6. Adlerstein was not informed of the proposal, the teleconference, or the draft documents.

During the meeting on July 9, 2001, Adlerstein began to discuss the arbitration. Wertheimer interrupted and told Adlerstein the board needed to address the company's finances. Wertheimer stated that Reich had made a proposal and handed Adlerstein a term sheet. After reviewing it, Adlerstein said he was not interested because it would deprive him of control. Wertheimer and Mencher responded that, in their judgment, the company needed funds immediately. They asked Adlerstein if he could provide funding, and Adlerstein said no. Wertheimer and Mencher tried to have further dialogue about alternatives, but Adlerstein refused to engage. Wertheimer then moved the transaction for a vote, and he and Mencher voted in favor. Wertheimer and Mencher next discussed removing Adlerstein for cause from his positions as Chairman and CEO, which they did. After the meeting, Reich's investment vehicle, which now held a majority of the outstanding voting power, delivered a written consent removing Adlerstein as a director. Some months later, Adlerstein delivered a written consent of his own removing Wertheimer and Mencher.

The *Adlerstein* decision first held that the July 2001 special meeting was validly called and convened. *Id.* at *8. It then turned to the "more difficult issue" of whether the directors' decision to keep Adlerstein uninformed about their plan rendered the actions taken at the meeting invalid. *Id.* at *9. The decision noted that several factors weighed in favor of validity. First, SpectruMedix had no provision in its charter or bylaws requiring prior notice of agenda items for meetings of the board, and Delaware lacks "any hard and fast legal rule that directors be given advance notice of all matters to be considered at a meeting." *Id.* Second, Wertheimer and Mencher acted in the good faith belief that Adlerstein needed to be removed and that, if told about Reich's proposal, "he would have done something to kill the deal." *Id.* Third, SpectruMedix faced insolvency, which created exigencies demanding fast action. *Id.*

Notwithstanding these factors, the opinion found that Adlerstein had an equitable right to (i) receive advance notice of the other directors' plans and (ii) decide whether to exercise his contractual power as a stockholder to prevent the board from taking action. *Id.* The decision cited *VGS* as supporting that result, but observed that the defendants had raised distinctions that made it "difficult to accept" that *VGS* would apply. *Id.* The opinion then cited *Koch*, which it treated as controlling. The opinion did not discuss the fact that *Koch* had been vacated by the Supreme Court, nor did it review the differences between the analytical approaches in *Koch* and prior case law.

In a footnote, the *Adlerstein* decision noted the unique nature of the equitable notice right, stressing that "[t]he outcome in this case flows from the fact [that] Adlerstein was both a director and a controlling stockholder, not from either status

individually." *Id.* at *9 n.28. The decision recognized that Adlerstein would not be entitled to notice as a stockholder:

> In the absence of some special contractual right, there is no authority to support the argument that Adlerstein's stockholder status entitled him to advance notice of actions proposed to be taken at a meeting of the board of directors. The actions may be voidable if improperly motivated. But the absence (or presence) of notice is not a critical factor.

Id. (citation omitted). The decision also recognized that Adlerstein would not have an equitable right to advance notice as a director. "Similarly, in the absence of a bylaw or other custom or regulation requiring that directors be given advance notice of items proposed for action at board meetings, there is no reason to believe that the failure to give such notice alone would ordinarily give rise to a claim of invalidity." *Id.*

Yet despite these settled propositions, the *Adlerstein* decision concluded that the two capacities together gave rise to a trumping hybrid notice right:

> Nevertheless, when a director either is the controlling stockholder or represents the controlling stockholder, our law takes a different view of the matter where the decision to withhold advance notice is done for the purpose of preventing the controlling stockholder/director from exercising his or her contractual right to put a halt to the other directors' schemes.

Id. It is open to debate how zero plus zero somehow adds up to more than Section 141.

Adlerstein relied heavily on *Koch*, a decision that the Supreme Court vacated, and on *VGS*, an opinion that turned on seemingly unique features of the LLC agreement at issue in that case. Nevertheless, *Adlerstein* remains good law. Klaassen's reliance on the decision therefore gives rise to fair questions for litigation on appeal.

e. *Fogel*

The final advance notice decision on which Klaassen relies, and the last in the *Koch* line of authority, is *Fogel*, a case which further expanded the concept of disadvantage to elevate the equitable power of an officer over the Section 141(a) authority of the board. The *Fogel* litigation arose after the board of directors of U.S. Energy Systems, Inc. terminated Asher Fogel, the company's Chairman and CEO. Like SpectruMedix in the *Adlerstein* case, U.S. Energy was a publicly traded Delaware corporation that fell into financial difficulty. Fogel responded by scheduling a special board meeting for June 29, 2007, for the stated purpose of interviewing and hiring a financial advisor or restructuring officer. In the days leading up to the meeting, the three independent directors on the board discussed their concerns with Fogel's performance and reached a consensus that Fogel should be terminated. On the morning of June 29, the three directors decided to fire Fogel. Before the special board meeting officially began, the independent directors told Fogel that they had lost faith in him and wanted him to resign. Fogel disputed that the directors could fire him, then left. The three independent directors remained and conducted the scheduled interviews. That evening, one of the directors called Fogel and asked whether he had decided to resign. When Fogel declined, the director told him he was terminated. *See Fogel*, 2007 WL 4438978, at *1-2.

Two days later, Fogel called a special meeting of stockholders for the purpose of voting on the removal of the other directors and the election of replacements. The company's bylaws authorized the Chairman to call a special meeting of stockholders. The directors ignored Fogel's call of the special meeting of stockholders and did not take steps to schedule or convene it. *Id.* at *2.

Fogel then filed a Section 225 action challenging his removal. The central issue in the case was whether the board actually met on June 29, 2007. After conducting a trial and reviewing the factual record, the court found that no board meeting had occurred and that Fogel therefore had not been terminated. *Id.*

As an alternative basis for its holding, the *Fogel* decision stated that "the meeting was not properly noticed and is therefore void." *Id.* at *3. Relying heavily on *Koch*, the opinion characterized the independent directors as having tricked Fogel about the true purpose of the meeting by failing to give him advance notice of their plan to terminate him. *Id.* Like *Adlerstein*, the *Fogel* decision credited the independent directors' good faith belief that terminating Fogel was in the best interests of the company. *Id.* The decision nevertheless held, following *Koch*, that the directors deceived Fogel by not specifically warning him in advance about his potential termination. The *Fogel* decision did not discuss the fact that the Supreme Court vacated the decision in *Koch* or consider the differences in approach between *Koch* and prior precedent.

Fogel was not a controlling stockholder, and the *Fogel* decision recognized that he lacked the votes to protect his position as Chairman and CEO. Nevertheless, the opinion found that he was disadvantaged because "had he known beforehand, he could have exercised his right under the bylaws to call for a special meeting *before* the board met." *Id.* at *4. In other words, even though Fogel lacked the ability to change the board's composition himself, the board had to give him the opportunity to ask the stockholders to do it for him, and the board could not remove Fogel unless they did. The opinion did not

consider whether by calling the special meeting of stockholders to protect his job, Fogel improperly used a power held in a fiduciary capacity for the purpose of entrenchment.

By extending the special equitable advance notice requirement to an officer with the power to call a special meeting of stockholders, *Fogel* dramatically expanded the *Koch* line of cases. Under Section 211(d), special meetings of stockholders may be called by the board of directors or by such person or persons as are authorized in the charter or bylaws. 8 *Del. C.* § 211(d). Corporate bylaws commonly contain a provision conferring the power to call a special meeting on either the Chairman of the Board, the senior-most corporate officer, such as the CEO or President, or both.[6] It remains common for a single individual to be both Chairman and CEO.[7] Often it is said that a board's most important task is to hire, monitor, and fire the CEO.[8] If *Fogel* is correct,

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[6] *See, e.g.*, *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 465 (Del. 1995) (empowering chairman to call special meeting of stockholders); *Perlegos v. Atmel Corp.*, 2007 WL 475453, at *25 (Del. Ch. Feb. 8, 2007) (same); *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 487 n.4 (Del. Ch. 1995) (same); *Campbell v. Loew's, Inc.*, 134 A.2d 852, 855-56 (Del. Ch. 1957) (Seitz, C.) (empowering president to call special meeting of stockholders). *See generally* 2 David A. Drexler et al., *Delaware Corporation Law & Practice* § 24.02 at 24-3 (2012) ("[I]n many instances, bylaws give the power to call special meetings to the chief executive officer, a specified number of the directors, and a fixed percentage of stockholders entitled to vote."); 2 Alan S. Gutterman, *Business Transaction Solutions* § 8.52 (2013) ("Special meetings . . . may be typically called by the corporate secretary, the chairman of the board, the president or other authorized people described in the bylaws.").

[7] *See, e.g.*, Z. Jill Barclift, *Corporate Governance and CEO Dominance*, 50 Washburn L.J. 611, 620 (2011) (citing study from 2007 finding roles were combined at two-thirds of S&P 500 companies); Nicola Faith Sharpe, *Informational Autonomy in the Boardroom*, 2013 U. Ill. L. Rev. 1089, 1102 (citing studies from 2009 and 2008 finding that roles were combined at 60% of S&P 500 companies).

[8] *See, e.g.*, Douglas G. Baird & Robert K. Rasmussen, *The Prime Directive*, 75 U. Cin. L. Rev. 921, 923 (2007) ("The challenge of hiring and firing managers is the single most important job that directors face."); Ira M. Millstein, *The Evolution of the Certifying Board*, 48 Bus. Law.

then a board with a Chairman/CEO cannot fire its CEO without first giving the CEO explicit advance notice and an opportunity to call a special meeting of stockholders at which the composition of the board might change, regardless of how few shares the Chairman/CEO owns. Such a rule has profound effects for all Delaware corporations and particularly for publicly traded issuers like the corporation in *Fogel*. The *Fogel* decision demonstrates the profound tensions between the *Koch* line of cases and Section 141 of the DGCL and poses a significant threat to board-centrism.

The Supreme Court has not had the opportunity to address (i) the persuasiveness of the reasoning in the vacated *Koch* decision, (ii) the differences between the analytical approaches taken in *Koch* and those followed in earlier precedents, (iii) whether the case-specific holdings with respect to the LLC in *VGS* apply to Delaware corporations, (iv) *Adlerstein*'s cautious acceptance (based on *Koch* but without considering its vacated status) of an equitable advance notice right for a controller-director hybrid, or (v) the expansion in *Fogel* of the equitable advance notice right to a Chairman/CEO who can call a special meeting of stockholders. Moreover, in this case Klaassen seeks to expand the equitable notice right yet again by extending it beyond a special board meeting to

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1485, 1494 (1993) ("[O]ne of the board's most important functions is to evaluate the performance of the CEO, and to replace an underperformer in a timely fashion."); *see also* Melvin Aron Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, 63 Calif. L. Rev. 375, 403 (1975) ("[The Board] is optimally suited to . . . selecting, monitoring, and removing the members of the chief executive's office. It therefore follows that the primary objective of the legal rules governing the structure of corporate management should be to ensure effective performance of that cluster of functions. . . .") (footnote omitted); Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. Ill. L. Rev. 1051, 1075 (2013) ("Appointing a CEO, after all, is likely the most important decision a board will ever make.").

encompass a regular board meeting, thereby eliding a distinction that has existed since *Lippman*. But with four trial court decisions in his quiver, Klaassen has certainly raised fair questions that warrant further litigation on appeal.

2. The Equitable Defenses

To avoid confronting the litany of issues presented by the notion of equity conferring super-director powers on a controller-director hybrid (*Koch* and *Adlerstein*) or a CEO-director hybrid (*Fogel*), the Opinion reasoned that even if the rule Klaassen proposed were assumed to be correct, it was nevertheless a rule of equity. Consequently, the Opinion inferred that equitable defenses could be raised in response. In corporate lingo, the Opinion held that when the Board removed Klaassen, that action was at most voidable in equity. Klaassen has stated that he plans to rely on the *Koch* line of authorities to establish that the actions taken on by the Board not voidable but rather void and therefore not subject to equitable defenses.

Under Supreme Court precedent, "[t]he essential distinction between voidable and void acts is that the former are those which may be found to have been performed in the interest of the corporation but beyond the authority of management, as distinguished from acts which are [u]ltra vires, fraudulent or gifts or waste of corporate assets." *Michelson v. Duncan*, 407 A.2d 211, 218-19 (Del. 1979). The Opinion noted that all but one of the pre-*Michelson* decisions addressing improper notice involved situations where either (i) the bylaws required advance notice for a special meeting that was not given at all or (ii) the bylaws required that notice be given in a particular manner and the requirements were not followed, and that in each case, these decisions described the actions taken at

the improperly noticed meetings as "invalid," "illegal," or "void" without exploring whether the acts were voidable or considering ratification or equitable defenses.[9] The Opinion noted that in one pre-*Michelson* decision, this court analyzed the facts surrounding a meeting and ultimately determined that the actions taken were "void," but only after considering the equities. *See Schroder*, 299 A.2d at 435.

Turning to the post-*Michelson* precedent, the Opinion observed that decisions addressing improperly noticed board meetings typically have not considered whether the actions taken were voidable rather than void and that this issue was not raised in the *Koch* line of cases. Therefore, although the *Koch* decisions use the term "void," it is difficult to read them as offering definitive guidance on the issue, particularly given the other difficulties presented by those decisions.[10] Two other decisions, by contrast, have addressed the void-versus-voidable distinction and cited *Michelson*. *See Nevins v. Bryan*, 885 A.2d 233, 245 (Del. Ch. 2005); *Moore Bus. Forms, Inc. v. Cordant Hldgs. Corp.*,

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[9] *See Seminole Oil*, 1958 WL 55434, at *1 (holding actions taken at board meeting to be "invalid" where "[a]ll the directors were entitled to notice [of the meeting] and admittedly Mrs. Richardson, a director, did not receive such a notice"); *Bruch*, 116 A. at 740 ("Unless notice be given to each director of a special meeting of the board of directors as required by the by-laws, the meeting is illegal and action taken thereat is not binding."); *Lippman*, 95 A. at 898 ("It is, of course, fundamental that a special meeting held without due notice to all the directors is not lawful, and all acts done at such meeting are void.").

[10] *See Fogel*, 2007 WL 4438978, at *3 (quoting *Schroder* for principle that all acts done at an improperly noticed meeting are "void" without addressing *Michelson* test); *Adlerstein,* 2002 WL 205684, at *10 (citing *Koch* for principle that acts done at improperly noticed board meeting were "void" without addressing *Michelson* test); *VGS*, 2000 WL 1277372, at *5 (holding that actions taken at board meeting were "invalid" without addressing *Michelson* test); *Koch,* 1992 WL 181717, at *4 (citing *Schroder* for principle that all acts done at an improperly noticed meeting are "void" without addressing *Michelson* test).

1998 WL 71836, at *9 (Del. Ch. Feb. 4, 1998); *see also Hockessin Cmty. Ctr., Inc. v. Swift*, 59 A.3d 437, 462 (Del. Ch. 2012).

After reviewing these authorities, the Opinion posited that Delaware law distinguishes between (i) a failure to give notice of a board meeting in the specific manner required by the bylaws and (ii) a contention that the lack of notice was inequitable. In the former scenario, board action taken at the meeting is void. In the latter scenario, board action is voidable in equity, so equitable defenses apply. The Opinion noted that this distinction fits with the general rule that the stockholders, through bylaws, may dictate the process that directors use to manage the corporation, so long as the restrictions are not so onerous as to interfere with the board's power to manage the corporation under Section 141(a).[11] The distinction also recognizes that, traditionally, when a board took action in contravention of a mandatory bylaw, the board action was treated as void.[12] At the same time, the Opinion noted that "the case law in this area has

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[11] *See CA, Inc.*, 953 A.2d at 240 (suggesting that mandatory bylaw should include a fiduciary out because otherwise it would be binding on the board); *Hollinger I*, 844 A.2d at 1080 n.136 (Del. Ch. 2004) ("[B]ylaws may pervasively and strictly regulate the process by which boards act, subject to the constraints of equity."); Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-laws: Taking Back the Street?*, 73 Tul. L. Rev. 409, 484 (1998) ("[T]he stockholders have considerable authority to adopt by-laws limiting the way in which the board of directors conducts its business.").

[12] *See, e.g.*, Henry Winthrop Ballantine, *Ballantine on Corporations* 440 (1946) ("Directors and officers are bound by the by-laws . . . ."); 8 William Meade Fletcher et al., *Fletcher Cyclopedia of the Law of Corporations* § 4197, at 803-04 (perm. ed., rev. vol. 2010) ("The corporation, and its directors and officers, are bound by and must comply with [the bylaws.]") (footnote omitted); William J. Grange, *Corporation Law for Officers and Directors* 63 (1935) ("In the case of a mandatory by-law the non-observance of its instructions renders the act performed or the thing done void and of no effect."); 2 Seymour D. Thompson & Joseph W.

not always been consistent, and some cases apply equitable defenses even if a bylaw was violated." Opinion, 2013 WL 5739680, at *19 n.10. The Opinion further recognized that a line "between a lack of notice that contravenes formal requirements in the constitutive corporate documents (where the meeting and related actions are void and not subject to equitable defenses) and a lack of notice that is deemed inconsistent with general principles of equity (where the meeting and related actions are voidable and subject to equitable defenses)" necessarily represented "one trial judge's effort and may not accurately reflect Delaware law." *Id.*

By proceeding in this fashion, the Opinion reached fewer contestable issues than it would have had it addressed directly Klaassen's claim to a special equitable notice requirement. But the Opinion still had to hazard views on unsettled questions of Delaware law. To be understated, they present fair questions for appeal.

E. The Scope Of The Stay

Taken together, the *Kirpat* factors favor the issuance of some form of stay. Klaassen appropriately does not seek a complete stay of the Opinion, nor does he contend that any interim action by the Board would inflict irreparable harm. He only asks that certain paragraphs of the original Status Quo Order remain in place.

First, Klaassen seeks to continue paragraph 2(a) of the Status Quo Order, which would ensure that during the pendency of the appeal, with one exception, the Board

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Thompson, *Commentaries on the Law of Corporations* § 1280 (3d ed. 1927) (explaining ability of bylaws to bind board of directors).

remains as set by the Court in the Opinion and Final Order. To preserve the parties' ability to return to the pre-Opinion status quo if Klaassen's appeal succeeds, this aspect of the motion is granted. The one exception is that the Opinion held that John Brown had been validly elected as the Common Director. The parties agree that Brown has resigned from his seat and ask that he be permitted to do so. Consequently, pending the outcome of the appeal, the Board comprises Pehl and Forlenza as Series A Directors with one Series A Director vacancy, Klaassen and Hood as Remaining Directors with one Remaining Director vacancy, and no Common Director.

Second, Klaassen seeks to continue paragraphs 2(f) and 2(j) of the Status Quo Order, which prevent the hiring or terminating of officers and senior level employees or changes in the terms of employment of officers and senior level employees, including through the adoption of a management incentive plan. The Status Quo Order imposed these restrictions on the Company's executives and senior employees two levels below the executive rank. Since the entry of the Status Quo Order, the court has learned more about Allegro, its business, and how the Company functions. At this point, a restriction on employees two levels below the executive rank seems overly broad. Paragraphs 2(f) and 2(j) shall continue in effect pending appeal, but they shall apply only to the CEO and his direct reports.

Third, Klaassen seeks to continue paragraphs 2(l) and 2(m) of the Status Quo Order, which would prevent Allegro from spending or entering into transactions in excess of 15% of Allegro's budget for 2013 that was adopted in December 2012. The trial record and the Hood and Forlenza affidavits indicate that Allegro has grown materially

and that the Board needs to set a new budget for 2014. Pending the outcome of the appeal, the Board may develop and adopt a 2014 budget so long as no single budget category receives a percentage increase greater than the percentage growth in Allegro's 2013 revenue over 2012. In other words, the Board can budget for straight line, year-over-year growth. The 15% cap will be based on the 2014 budget. Although this restriction risks limiting the Company's opportunities, it should remain in effect only for a brief time because the Supreme Court has expedited the appeal.

Last, Klaassen seeks to keep paragraph 2(o) in place, which constrains Allegro from entering into any legally binding commitment to take any action that the Status Quo Order otherwise restricts. This sensible provision prevents a party from doing indirectly what it could not do directly. It shall remain in place pending appeal.

The defendants request that any order granting a stay be conditioned on Klaassen posting $1 million in security. As noted, Article IV, § 24 of the Constitution of the State of Delaware requires adequate security for a stay pending appeal. The defendants have identified business opportunities and organizational changes that could be impaired by a stay, and the requested amount appears reasonable in comparison. Given Klaassen's personal wealth, the cost of securing a supersedeas bond in the amount of $1 million should not interfere with his ability to pursue an appeal.

II. CONCLUSION

Klaassen's motion for a stay pending appeal is granted in part. An implementing order will be entered.