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Case No. 8626-VCL

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: September 27, 2013
Date Decided: October 11, 2013

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LASTER, Vice Chancellor.

Plaintiff Eldon Klaassen brought this action pursuant to Section 225 of the Delaware General Corporation Law (the "DGCL") to obtain a determination that he remains CEO of Allegro Development Corporation ("Allegro" or the "Company"). He further contends that as the holder of virtually all of the Company's common stock, representing a majority of Allegro's outstanding voting power, he acted by written consent to remove two incumbent directors, fill the two resulting vacancies, and fill a pre-existing vacancy. The defendants respond that the Allegro board of directors (the "Board") properly removed Klaassen as CEO and replaced him with defendant Raymond Hood. They regard Klaassen's consent as ineffective such that Klaassen and the four individual defendants currently constitute the Board.

This post-trial decision holds that (i) Klaassen cannot challenge his removal as CEO, (ii) Klaassen continues to serve as a director, (iii) Klaassen validly removed defendant George Patrich Simpkins from the Board but did not validly remove Hood, (iv) Klaassen did not validly fill the vacancy created by Simpkins's removal, and (v) Klaassen validly filled a vacant directorship with non-party John Brown. To sum up, Hood is Allegro's CEO, and Klaassen, Hood, Brown, and defendants Michael Pehl and Robert Forlenza are its directors.

I. FACTUAL BACKGROUND

The following facts were proven at trial by a preponderance of the evidence. The parties commendably stipulated to a number of facts in the pre-trial order. Klaassen bore the burden of proof on his claims, and the defendants bore the burden of proof on their counterclaims and affirmative defenses.

A. Allegro And The Series A Transaction

Allegro is a privately held Delaware corporation headquartered in Dallas, Texas. The Company is a leading provider of software for energy trading and risk management ("ETRM"). Klaassen founded the Company in 1984, and for over twenty years he operated it as an S corporation and owned nearly 100% of the stock.

In 2007, Klaassen solicited funds from outside investors to monetize a portion of his holdings. The best terms came from North Bridge Growth Equity 1, L.P. ("North Bridge"), which proposed a total investment of $40 million in Allegro at a pre-money valuation of $130 million with North Bridge supplying at least $30 million of the capital. Pursuant to a Stock Purchase Agreement dated December 20, 2007, North Bridge invested $30 million in return for shares of Series A Preferred Stock (the "Series A Preferred"). On January 18, 2008, Tudor Ventures III, L.P. ("Tudor") supplied the remaining $10 million, also in return for Series A Preferred. Under the terms of the deal, Allegro used the $40 million to repurchase common stock and options that Klaassen and certain other executives held. Klaassen received the bulk of the $40 million. Post-transaction, Klaassen continued to hold virtually all of Allegro's common stock, initially representing approximately 70% of the Company's fully diluted equity. North Bridge and Tudor (together, the "Series A Investors") owned all of the Series A Preferred, initially representing approximately 30% of the Company's fully diluted equity.

As part of the Series A transaction, Allegro amended and restated its certificate of incorporation (JX 11, the "Charter") and bylaws (JX 12, the "Bylaws"). Klaassen and the Series A Investors also entered into a Stockholders' Agreement dated as of December 20,

2007, to which Allegro was made a party. JX 10 (the "Stockholders' Agreement"). These documents established a corporate governance structure in which Klaassen and the Series A Investors shared control at both the director and stockholder levels.

At the director level, Klaassen and the Series A Investors agreed on a Board of seven members and specified this number in the Bylaws. *See* JX 12 Art. II § 2. The Charter provided the holders of a majority of the Series A Preferred, voting together as a separate class, with the right to elect three directors (the "Series A Directors"). JX 11 § 3.3.1. The Charter provided holders of a majority of the common stock, voting together as a separate class, with the right to elect one director (the "Common Director"). *Id.* The holders of a majority of Allegro's outstanding voting power, with all shares voting together and on an as-converted basis, elect the remaining three directors (the "Remaining Directors"). *Id.*

Post-closing and at all times relevant to this case, Klaassen controlled a majority of Allegro's outstanding voting power through his ownership of the common stock, which nominally gave him the right to elect the Remaining Directors. Under the Stockholders' Agreement, however, Klaassen and the Series A Investors agreed to vote their shares to maintain the composition of the Board as follows: one Remaining Director seat would be filled by the CEO (the "CEO Director"), and the other two Remaining Directors seats would be filled by outsiders who were neither stockholders nor affiliated with any stockholder, such individuals to be designated by the CEO and approved by the Series A Investors (the "Outside Directors"). *See* JX 10 § 9.2(c)-(d). For convenience, this decision refers to the Series A Directors and the Outside Directors

collectively as the "Non-Management Directors." The term excludes the Common Director only because that seat remained vacant until June 2013, just before Klaassen filed this lawsuit.

As suggested by the absence of a Common Director, Klaassen and the Series A Investors never fully implemented the seven-director arrangement. Instead, the Board reached stasis at five directors. In 2012, when the events giving rise to this litigation took place, the Series A Investors had filled two of the Series A Director seats with Pehl, a managing director from North Bridge, and Forlenza, a managing director from Tudor. Klaassen served as one of the Remaining Directors in the CEO Director seat. In his capacity as CEO, Klaassen had designated two Outside Directors, and the Series A Investors had approved both. As noted, Klaassen never elected the Common Director. Although Klaassen considered it, he reasoned that the Series A Investors would respond by filling their additional Series A Director seat. Klaassen and the Series A Investors ended up sharing control over the Board essentially as planned, with neither Klaassen nor the Series A Directors designating a majority of the seats and the Outside Directors furnishing the swing votes.

At the stockholder level, Klaassen and the Series A Investors similarly shared control. In the Charter, Klaassen and the Series A Investors enjoyed the benefit of the same protective consent rights, such as the right to block (i) "any Liquidation Event or Deemed Liquidation Event," (ii) any amendments to the Charter or Bylaws, (iii) the creation, authorization, or issuance of any additional class or series of capital stock, (iv) the issuance of any additional shares or any increase in the authorized number of

shares of the common stock or Series A Preferred, or (v) any increase in the number of directors or change in the election procedure for the Board. JX 11 § 3.4. The Charter provided that "so long as Eldon Klaassen is the record owner of at least 33% of the outstanding shares of capital stock" on a fully diluted basis, Allegro could not engage in any of these actions (plus others not referenced here), without both Klaassen's consent *and* the separate consent of the holders of a majority of the Series A Preferred. *Id.* In addition, as long as Klaassen held shares representing a majority of Allegro's outstanding voting power, he could control the outcome of any vote in which all of the shares voted together as a single class, without resort to his Charter-based consent right.

In negotiating the Series A transaction, the parties contemplated means by which the Series A Investors could exit from their investment. When they bought into the Company, the Series A Investors anticipated a five-year holding period. At trial, all of the witnesses, including Pehl and Forlenza, stressed that fact. To ensure that they had the ability to initiate an exit process, the Series A Investors bargained for the right to require Allegro to redeem their shares, subject to the limitations imposed by the DGCL and common law, at any time after December 20, 2012. The redemption price would be the greater of (i) the initial investment price of $40 million or (ii) "Fair Market Value," in each case plus accrued and unpaid dividends. *See* JX 11 §§ 6.1-6.2. The Charter defined "Fair Market Value" as an amount determined in good faith by the Board and the holders of a majority of the Series A Preferred, but further provided that if a determination was not made within twenty days after receipt of a redemption notice, the amount would be

determined by an investment banking firm chosen by the Series A Investors and reasonably acceptable to the Company. *See id.* § 6.5.

A more promising exit for the Series A Investors would be a sale. For that outcome, the Series A Investors bargained to receive an initial liquidation preference equal to two times their investment of $40 million, plus all accrued and unpaid dividends (the "2x preference"). Once the 2x preference was paid, all of the incremental value in any sale below $170 million would go to the common stock. At trial, the Series A Investors referred to this gap in their returns as the "donut hole." At deal prices above $170 million, the Series A Preferred resumed sharing in the incremental gains and would receive a somewhat greater than *pro rata* share of the upside, but with the common stock taking a progressively larger share as the valuation approached $390 million. At deal prices over $390 million, the Series A Preferred and the common stock would share the transaction value on a strictly *pro rata* basis. *See id.* § 2.1.

As part of the shared-control structure, the Series A Investors did not obtain sufficient power at the Board and stockholder levels to force a sale. As discussed, Board control was split. Likewise, at the stockholder level, Klaassen could exercise the voting power carried by his common stock, which represented a majority of the Company's outstanding voting power, or invoke his Charter-based consent right as long as he held at least 33% of the outstanding shares. The Series A Investors bargained for a drag-along right on Klaassen's shares in the Stockholders' Agreement, but Klaassen had a veto on that as well. As long as Klaassen owned at least 33% of the outstanding shares, the Series A Investors could not exercise their drag-along right for a transaction offering less

than $390 million in aggregate consideration. JX 10 § 4.2(a). Klaassen's bundle of rights made him the gatekeeper for any exit by the Series A Investors at values below $390 million, unless the Series A Investors chose redemption.

B. The Decision To Terminate Klaassen

On November 1, 2012, the Board removed Klaassen as CEO during a regular Board meeting and replaced him with Hood. The Non-Management Directors had spent August, September, and October of 2012 considering whether to terminate Klaassen, who should replace him as CEO, and how to go about doing it. The different individuals on the Board did not share a singular moment of clarity in which they collectively realized that Klaassen needed to go. Their dissatisfaction grew at different rates over time. Indeed, the Series A Investors harbored concerns about Klaassen from the start and wanted him to broaden his management team immediately to include an outside professional executive. To that end, they bargained as a term of the Stockholders' Agreement for Allegro to hire Chris Larsen as COO to handle day-to-day operational tasks. In a pattern that would repeat itself with other senior executives, Larsen resigned after ten months on the job because he could not work with Klaassen.

A large measure of the Series A Directors' dissatisfaction with Klaassen stemmed from Allegro's failure to perform as anticipated. In the private placement memorandum ("PPM") circulated to potential investors in 2007, Allegro projected revenue of $61 million in 2008, $75 million in 2009, and $85 million in 2010. JX 4 at 11. Reality proved more sobering. In 2008, Allegro generated total revenue of approximately $46 million. By early 2009, the Series A Directors were worried about Allegro's

underperformance and thought Klaassen needed to improve his operational skills. At the time, Klaassen had not yet designated any Outside Directors, and the Series A Directors encouraged him to identify individuals who might mentor him in his weaker areas.

In June 2009, Klaassen designated Simpkins as an Outside Director. After conducting diligence, the Series A Investors approved him, and Simpkins joined the Board. He brought industry expertise in the ETRM sector and practical experience as a COO.

In December 2009, Klaassen designated Hood as the second Outside Director. After conducting diligence, the Series A Investors approved him, and Hood joined the Board in January 2010. Simpkins and Hood knew each other, having served at SensorLogic, Inc. as COO and CEO, respectively. It was Simpkins who recommended Hood to Klaassen. Hood brought his extensive experience as a CEO managing companies that ranged from pre-revenue startups to publicly traded corporations.

When Hood joined the Board, Klaassen's relationship with the Series A Directors was already strained. Although 2008 had been bad, 2009 was worse. Instead of the $75 million projected in the PPM, Allegro generated revenue of just $37.5 million and missed its budget by 30%. The Great Recession undoubtedly factored into the Company's struggles, but it was becoming clear that Klaassen's management style also contributed. To grow a business, a CEO must succeed across multiple dimensions, including assembling and retaining a talented executive team, empowering them to succeed, setting appropriate budgetary goals and implementing processes to achieve those goals, and communicating with the Board. Klaassen struggled in each of these areas. In particular,

the Series A Directors were frustrated by what they perceived to be Klaassen's persistent inability to provide the Board with accurate information. In the weeks and even days before the end of a quarter, Klaassen would give the Board updates that led the directors to expect good quarterly results. Then, after the quarter closed, he would deliver the bad news that the Company actually had missed its target. The Series A Directors understood the software business and were prepared to accept some volatility, but Klaassen seemed unable to get a handle on how the business was doing.

This pattern continued during 2010, and by October, the Series A Directors were ready to consider a CEO change. The Outside Directors, however, believed that Klaassen should be given more time. Hood explained to the Series A Directors that Klaassen seemed "very engaged in the 'go to market' process" and with the specific planning tools that Hood had suggested. JX 82. Hood thought Klaassen was "taking a long view" and had "plenty of fight in him." *Id.* Hood recommended that the Series A Directors "find ways to be supportive and make it work." *Id.* The Series A Directors were persuaded, and Hood told Klaassen that he had gotten him more time as CEO.

For a while, Klaassen justified the Outside Directors' confidence. In November 2010, Klaassen presented to the Board the go-to-market strategy that he had worked on with Hood. Although Allegro again missed its budget for the year, and the Company's revenue of under $35 million amounted to less than half the PPM figure of $85 million, Hood was pleased with Klaassen's progress and told him so. For 2011, Hood and the other Non-Management Directors worked with Klaassen to set a lower, more achievable budget that would create positive energy in the organization. Allegro actually achieved

its revenue budget during each of the first three quarters of 2011. While Klaassen continued to have difficulties recruiting and working with senior executives, there were signs of improvement.

Then came the fourth quarter of 2011, which was "ugly." JX 150. Klaassen described the quarter as "a disaster," JX 145, and he had no explanation other than that a couple of big deals slipped. JX 138. They did more than just slip, because the first quarter of 2012 was similarly bad. In a contemporaneous email, Klaassen tried to reassure Pehl that "[w]e can do better than this." JX 164.

C. The Year Of Redemption

Going into 2012, everyone on the Board understood that the Series A Investors' redemption right would ripen on December 20 and could be exercised at any time after that point. Prudently, the directors began planning for that eventuality.

At a Board meeting on April 19, 2012, redemption was a central topic of discussion. Hood offered to act as an intermediary between Klaassen and the Series A Investors. He also asked for authorization to hire independent counsel to express a view on the Company's redemption obligations. Allegro, through Klaassen, had obtained advice on the redemption mechanics from Gibson Dunn & Crutcher LLP, and the Series A Directors were receiving advice from Cooley LLP. Hood proposed to hire a third firm to express an independent view. The Board approved, and Hood hired Baker Botts LLP.

The documentation surrounding the retention of Baker Botts was not as clear as it could have been, and the parties disputed at trial whom Baker Botts represented. The Baker Botts engagement letter referred to a "special committee" of independent directors

as its client, but the Board never created a special committee. Baker Botts prepared its advice with the understanding that it would be provided to the full Board, leading Klaassen to argue that the full Board was Baker Botts's client. Baker Botts later advised the Non-Management Directors on issues surrounding Klaassen's removal, and Klaassen feels betrayed by the firm. Having considered the conflicting evidence and testimony, I find that Hood retained Baker Botts as counsel to the Outside Directors. Hood and Simpkins were Baker Botts's clients. Klaassen was never a client of Baker Botts.

At Hood's request, Baker Botts prepared and circulated a memorandum that addressed the redemption right. The memorandum made clear, and all of the directors understood, that the Series A Investors could not immediately force a full redemption if the Company did not have legally available funds, nor could the Series A Investors effectively convert their Series A shares into a debt claim against the Company. But the memorandum also explained, and the directors understood, that if Allegro could not finance a complete redemption, then the Board would have to determine regularly the amount of funds that Allegro could use for redemption and deploy those funds to buy back shares of Series A Preferred. Compliance with this obligation would constrain the Company's ability to reinvest in its business and grow. The threat posed by redemption therefore depended significantly on (i) the amount the Company would have to pay and (ii) whether the Company had sufficient funds legally available to redeem the Series A Preferred in full.

The Board's next regular meeting was scheduled for July 19, 2012. During the weeks before the meeting, Hood explored various alternatives with Klaassen and the

Series A Investors. Hood believed that the most logical solution was a third party sale. Unfortunately, the value of the Company in 2012 had fallen well below its 2007 pre-money valuation of $130 million. In any sale in that range, the Series A Investors would receive their 2x preference off the top, with the balance going to Klaassen and the other common stockholders. At the time, the 2x preference inclusive of dividends amounted to approximately $92 million and would consume the vast majority, if not all, of the proceeds in any transaction. Klaassen made it clear that he would not sell. Both as the holder of a majority of the outstanding voting power and under the Charter and the Stockholders' Agreement, Klaassen had blocking rights.

Another path was a recapitalization. One possibility was an external recapitalization in which the Company would take on debt or bring in a new investor and repurchase the Series A Preferred. A second possibility was an internal recapitalization that would reallocate the equity stakes of the Series A Preferred and the common stock to reflect the Company's lower valuation. The latter would have negative implications for Klaassen's control and would not result in a Series A exit, so the parties spent most of their time on the former.

In advance of the July 19, 2012, meeting, Klaassen proposed to have Allegro repurchase the Series A Preferred for $60 million, consisting of $40 million in cash and $20 million in subordinated debt. To support his offer, Klaassen obtained a valuation of the Series A Preferred from CBIZ Valuation Group, LLC, which placed the value of the Series A Preferred at between $39 and $47 million, including accrued dividends.

Klaassen argued that his $60 million offer was generous in light of the CBIZ valuation and represented more than the Series A Preferred could expect to receive in a redemption.

The Series A Investors regarded the CBIZ valuation as unreliable. They did not identify specific problems with the CBIZ methodologies, nor did they obtain a valuation of their own. They rather seem to have viewed CBIZ valuations as generally slapdash and superficial because boards often use them when pricing stock options, an exercise traditionally approached with less rigor than other valuation tasks. The Series A Investors took the position that what they might receive in redemption was irrelevant to what they wanted in a negotiated resolution. They demanded $92 million for their shares.[1]

As the July 19 meeting approached, another event raised the tensions between Klaassen and the Non-Management Directors. Just four days before the end of the quarter, Klaassen fired Brett Friedman, Allegro's Senior Vice President of Sales. Klaassen had no plan for a replacement, and the timing of the termination dismayed the Non-Management Directors. Although they did not oppose the termination itself, they had asked Klaassen to have a succession strategy and to wait until after the end of the quarter so as not to interfere with pending deals. The Non-Management Directors asked for an explanation, but Klaassen simply said Friedman had been insubordinate. Simpkins and Hood were particularly troubled by how Klaassen handled the firing. Simpkins "felt

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[1] Three months later, Allegro obtained a valuation from Duff & Phelps that valued the Series A Preferred at $54 million. Like the CBIZ valuation, the Duff & Phelps valuation implied a redemption price materially below the Series A Investors' demand for their shares.

like [Klaassen] had completely missed my coaching about having communication with the board and having faith in the board, and I was extremely surprised and very disappointed." Tr. 916. Hood saw a recurring pattern in which Klaassen could not work with new executives: "There was no leadership team being built, and the Company was going sideways . . . . We had the same exact executive team we had five years earlier." Tr. 744, 747.

On July 10, 2012, Hood asked Baker Botts to be prepared to discuss the mechanics for CEO termination at the July 19 meeting. In an email two days later, he explained his reasons for wanting to broach the subject:

> Eldon and his management team have had 4 years to get the Company moving and, for all intents and purposes, it is in stasis. His recent firing of the head of sales a few days before the Company posted its best sales quarter ever kind of spooked me . . . . It makes me wonder what a year delay [of redemption] does. . . . I think the [Series A] investors are pretty clear about how ugly things could get, but I think Eldon has rose-colored glasses on. Introducing some hard headed realism about the cost and damage that a fight or delay [of redemption] could cause might push the parties to compromise. That's my hope.[2]

Hood knew that Klaassen and the Series A were "very unhappy" with each other. Tr. 744-45. He felt that if he could "get them to just settle up and pay off each other," then he would have "done [his] job as an independent [director]," the shareholders would be "happy," and he could "happily walk away." Tr. 745.

[2] JX 215. The year delay refers to a provision in the Charter that permits the Company to defer redemption for up to twelve months. *See* JX 11 § 6.1. Hood's comment indicates that he believed the Company would not be able to finance a complete redemption of the Series A Preferred. Klaassen believed the redemption price would be low enough that Allegro could finance it.

D. The July 19 Meeting

During the Board meeting on July 19, 2012, the Board covered a full agenda of Company business. When it came time to discuss redemption, Baker Botts presented its analysis. Klaassen responded that the redemption right did not concern him. He also stated that before he would agree to a third-party sale, it would need to be a transaction that generated $100 million for him personally. Simpkins was struck by Klaassen's obsession with his own interests and his failure to consider other important corporate constituencies, such as the Company's employees.

The Non-Management Directors regularly met in executive session for a portion of each Board meeting, and on July 19 they discussed Klaassen's performance as CEO. Forlenza sensed for the first time that the Outside Directors had become frustrated with Klaassen, and he began to think that terminating Klaassen might be a viable option.

After the meeting ended, the Outside Directors asked Klaassen to remain for a private discussion. Hood told Klaassen that how he handled Friedman's termination seemed to be part of a recurring theme. Hood also encouraged him to compromise with the Series A Investors rather than put the Company in a position where its cash would be drained off to fund a periodic redemption requirement. Simpkins backed Hood. Klaassen reiterated that he was not concerned about redemption and contended that he could ignore it and "stonewall" the Series A Investors. Tr. 808 (Hood); Tr. 919 (Simpkins). The Outside Directors disagreed, and Hood pointed out that the Board could fire Klaassen: "[A]ll it takes if they have two [votes] is either me [Hood] or him

[Simpkins] to vote with them, and you're out of here as CEO." Tr. 809 (Hood); *accord* Tr. 675-76 (Hood); Tr. 918-20 (Simpkins).

E. Klaassen Consults With Counsel About The Termination Risk.

After meeting with the Outside Directors, Klaassen barreled into the office of Chris Ducanes, Allegro's General Counsel. Klaassen "looked very concerned and agitated" and asked if the Board could remove him as CEO. Tr. 881-84 (Ducanes). Ducanes told Klaassen that he "didn't have an employment contract and that he could be removed by the board." *Id.* Klaassen asked Ducanes to get a second opinion, so Ducanes contacted Gibson Dunn. In August, Gibson Dunn confirmed that there was no limitation on the Board's ability to terminate Klaassen as CEO.

F. The July 31 Meeting

At Hood's suggestion, the directors convened again on July 31, 2012. Simpkins participated by telephone, and the other directors attended in person. Although styled as a special meeting of the Board, the session was really an opportunity for Klaassen and the Series A Investors to discuss various alternatives and potentially negotiate a deal. The Series A Investors lowered their demand to $80 million, and they proposed selling Allegro as an alternative. Klaassen reiterated that he would not approve a sale and again offered $60 million.

To support the reasonableness of his $60 million offer, Klaassen gave a PowerPoint presentation designed to show that the value of Allegro as a whole did not support a higher figure. To prove his point, Klaassen detailed the Company's poor performance during the life of the Series A investment. Most strikingly, Klaassen

presented a slide that compared Allegro's performance to its two nearest competitors. According to the slide, Allegro's major competitors experienced organic growth of 20%-30% per year with healthy profit margins. Allegro had flatlined.

Klaassen's strategy backfired. Rather than persuasively making the case for a lower buyout price, Klaassen's presentation demonstrated just how badly the Company had performed. When Klaassen reached the slide that compared Allegro to its two nearest competitors, Pehl lost his temper. He slammed his phone down, said he would "not listen to this anymore," and left the room. Tr. 76 (Klaassen).[3] He later returned and the discussions continued.

Although the other Non-Management Directors did not react as strongly as Pehl, they took away the same message from Klaassen's exposition. Hood thought it was "a very poor presentation to give to investors," served as "an admission of failure," and reinforced what they already knew about Allegro's performance under Klaassen's leadership. Tr. 792, 795-96, 800-01. Simpkins questioned whether Klaassen was the person who could lead the Company. Forlenza became convinced that the Company's value had dropped too far for a sale or recapitalization to be feasible. As he saw it, the only possible path was to increase the Company's value.

Pehl and Forlenza shared a car to the airport after the July 31 meeting. During the ride, they brainstormed about how to increase the Company's value and discussed the

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[3] Pehl consistently denied that he had lost his temper at the meeting, but both Hood and Forlenza corroborated Klaassen's testimony. *See* Tr. 679-80 (Hood); Tr. 976-77 (Forlenza).

need to replace Klaassen as CEO. Both viewed Klaassen as a major impediment to the Company's growth. Neither had believed that the Outside Directors would contemplate terminating Klaassen, but after the July meetings, both thought the Outside Directors might have lost patience with Klaassen. Pehl contacted his assistant and asked her to schedule a teleconference among the Non-Management Directors.

During the first week of August, Hood continued trying to broker a recapitalization and urged both Klaassen and the Series A Investors to submit proposals. Klaassen stood on his $60 million number, although he increased the cash portion to $50 million. The Series A Investors held firm at $80 million and offered as an alternative an internal recapitalization in which Klaassen's equity stake would drop to 45%. Both were non-starters, causing Hood to conclude that the two sides would never reach agreement at the Company's current valuation.

G. The Non-Management Directors Discuss Terminating Klaassen.

On August 7, 2012, the Non-Management Directors held an initial call, without Klaassen, during which the Series A Directors raised the subject of replacing Klaassen as CEO. After the call, Hood contacted Baker Botts and asked for help understanding the ramifications of CEO replacement. The Non-Management Directors spoke again on August 17. The parties agree that various subsets of the Non-Management Directors talked more frequently among themselves, but it is not possible to pin down all of the conversations. Klaassen did not participate in any of the calls and did not know about them. He spent most of August out of the country.

By late August, the Non-Management Directors had reached a consensus that they needed to terminate Klaassen as CEO, but they faced a major hurdle: no clear successor. The Series A Investors discussed possibilities among themselves that included elevating Allegro's CFO to the CEO role and conducting a full executive search. They also discussed making Hood the CEO.

At some point, most likely in early September, Pehl asked Hood whether he would consider the job. Hood reacted negatively, asking Pehl why he would want to touch "this hairball." Tr. 747-49. But after speaking with his wife, discussing the issue further with the other Non-Management Directors, and considering the alternatives, Hood decided that it was best for the Company if he took on the challenge. At trial, Hood candidly recognized that this decision created a conflict of interest for him. He went on to explain credibly that in balancing the various factors, he considered that he historically had a good relationship with Klaassen, and he thought that he would be able to help successfully transition Klaassen into a more visionary, less operational role as an "evangelist" for the Company. Unlike a former subordinate or a new outsider, Hood thought he could work with Klaassen and that the two of them could form a "very good team." *Id.*

Hood also believed he could grow the Company for the benefit of both the Series A Investors and the common stockholders. In his previous position as CEO of Qumu, he had grown the Company and achieved a successful sale to Rimage at approximately five-and-a-half times revenue. Hood frankly admitted that not every one of his CEO tenures

had been successful, but he was an experienced, professional CEO with an established track record of creating value for investors.

In his discussions with Pehl, Hood agreed to take the job on the conditions that (i) he would receive a competitive compensation package, (ii) he could assemble his own management team, and (iii) he and his team would be able to share in some of the upside from growing the Company. Hood expected that Klaassen, in his visionary founder role, would continue to work with the Company as a highly compensated consultant.

Hood's willingness to take the CEO position convinced Forlenza that the best path for the Company would be to terminate Klaassen. Simpkins also viewed Hood's decision as a positive factor.

H. Klaassen Gets Worried.

Klaassen left the country again during early September. While away, he continued to exchange emails with Ducanes and Gibson Dunn about whether the Board could terminate him as CEO. They reiterated that the answer was "yes." After receiving that advice, Klaassen scheduled meetings with Simpkins and Hood.

Klaassen and Simpkins had dinner on September 17, 2012. Going into the dinner, Simpkins was leaning toward replacing Klaassen and felt the Non-Management Directors were "moving in that direction." Simpkins Dep. 77:23. At the same time, Simpkins continued to feel loyalty toward Klaassen. As Simpkins explained at trial, Klaassen "had brought me on the board, and I was concerned for him. . . . [A]nd I was concerned about the business." Tr. 922. Simpkins had invested years in mentoring Klaassen and "wanted to see him remain as CEO of the Company." *Id.* At the dinner, Simpkins had a "tough

conversation" with Klaassen, warned him "that his job was in jeopardy," and told Klaassen that he needed to respond to the Series A Investors. Tr. 922-24. Two days later, Simpkins sent Klaassen an email in which he reiterated the key points of his advice regarding a plan that would enable Klaassen to "remain as CEO." JX 306.

Klaassen and Hood had lunch on September 20, 2012. Hood also signaled to Klaassen that his job was in jeopardy and that his relationship with the Board was poor.

Around the same time, Allegro's CEO, Jarett Janik, scheduled a lunch with Hood. Janik told Hood that he believed the Company could finance a recapitalization at $70 million. Janik met with Hood on his own initiative in an effort to find a way to bridge the gap between the Series A Investors and Klaassen. Hood did not follow up on the idea of a $70 million compromise.

After his meetings with Simpkins and Hood, Klaassen sent a proposed management structure for the Company to Simpkins and Pehl. Simpkins felt that Klaassen's email "probably hit on one-tenth of one percent of what I was trying to convey to him, and it was just shocking that that's all he took from the dinner." Tr. 924-25. Simpkins called Pehl, told him about the dinner, and asked if Klaassen had discussed any of the other points with him. Simpkins testified that when he learned that Klaassen had not spoken with Pehl about any of the other issues, "it just took the wind out of my sails." Tr. 925.

I. The Final Preparations

By September 29, 2012, Hood believed he would be replacing Klaassen, and he began making specific plans to build his management team. He and Pehl discussed

Hood's potential compensation as CEO and the need for a management incentive plan ("MIP") to incentivize Hood and his new team. The initial draft of the MIP favored the interests of the Series A Preferred, and Hood noted that "[i]n effect, this all comes out of the common." JX 432. Subsequent drafts contemplated that the Series A Preferred and the common stock would share the cost of the MIP to varying degrees.

By early October 2012, Hood, Forlenza, and Pehl had decided to replace Klaassen.[4] Simpkins reached that conclusion after receiving Hood's report on the reasons for the resignation of Reiner Musier, Allegro's Chief Marketing Officer. Musier resigned on September 18, 2012, the day after Simpkins's dinner with Klaassen. On October 11, Hood met with Musier to understand his reasons for leaving. Musier attributed his departure to "Eldon's leadership style," explaining that "all ideas have to come from Eldon," that Eldon would "demean members of the team" without offering encouragement, and that he was troubled by Klaassen's tendency to shut down good projects if they were not his own ideas. JX 323. Musier viewed the Company as being in "precarious shape" and "going nowhere under Eldon's leadership." *Id.*

For Simpkins, this was "the last straw." Tr. 927. As he explained at trial, "for two and a half years, I had mentored/coached Eldon in his relationships with the board

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[4] Pehl testified in his deposition that he was still "50/50" on replacing Klaassen until November 1, when the Board actually terminated him. That testimony was not credible. The evidence clearly demonstrates that Pehl was the first to conclude that terminating Klaassen was necessary, and he took the lead in organizing the discussions among the Non-Management Directors. At trial Pehl persisted in claiming that even after the Non-Management Directors met in executive session on November 1 and affirmed their belief that Klaassen should be terminated, Klaassen somehow could have convinced Pehl to change his mind. It is frankly baffling why Pehl testified in this fashion.

and with management and hiring an executive management team and empowering them, and I just felt like he had ignored all this; and it was confirmation to me." Tr. 927; *see also* JX 323. Simpkins concluded that replacing Klaassen was the only way for Allegro to grow. Tr. 941.

Having reached a consensus that Klaassen needed to be replaced, the Non-Management Directors decided to act at the next regularly scheduled Board meeting, set for November 1. They held preparatory teleconferences on October 19 and October 26. Baker Botts prepared a draft resolution ousting Klaassen, which the Non-Management Directors reviewed. The Series A Investors' counsel prepared a script for the November 1 meeting and asked whether Klaassen should be given advance notice. The Non-Management Directors decided that it was important not to give Klaassen notice because they needed to make sure that they had control over the Company's bank accounts, intellectual property, and other key assets. As Forlenza testified,

> [I]f we told him we were terminating [him], that would give him an opportunity to take actions in the company that could be detrimental to the company. The last thing we wanted was an irate CEO with access to code, with access to cash and most importantly with access to employees to poison the well for the change that was coming.

Forlenza Dep. 158:5-12.

J. The November 1 Meeting

The Board convened during the afternoon of November 1, 2012. Before the meeting, Hood sent an email to Klaassen telling him that the Board needed Ducanes and Janik to be present to discuss the "redemption" issue. Hood admitted that the email was a ruse and that he actually needed Ducanes and Janik at the meeting to implement

Klaassen's termination. The email did not have any effect on Klaassen's attendance. The November 1 meeting was a regular meeting of the Board that Klaassen would have attended and led regardless.

The November 1 meeting started like any other Board meeting with Klaassen and Janik presenting on various topics. Toward the end of the meeting, the Non-Management Directors asked Klaassen, Ducanes, and Janik to leave the room so they could meet in executive session, a normal occurrence. During the executive session, the Non-Management Directors reaffirmed their decision to replace Klaassen. They did not debate the pros or cons of removing Klaassen and replacing him with Hood; those matters already had been discussed extensively. No one represented Klaassen's position.

After approximately fifteen minutes, the Non-Management Directors asked Janik and Ducanes to join them. They informed Janik and Ducanes that Hood was replacing Klaassen as CEO, and they instructed Janik and Ducanes to secure the Company's bank accounts, intellectual property, and other key assets. Janik and Ducanes left.

The Non-Management Directors then called Klaassen in. Pehl informed Klaassen that the Non-Management Directors had decided to remove him as CEO and handed him the resolution prepared by Baker Botts, which stated that "the Board deems it advisable and in the best interests of the Company that Mr. Klaassen no longer serve as an officer or employee of the Company and that Ray Hood be appointed acting Chief Executive Officer of the Company in his place." Pehl called for a vote on the resolution. All four Non-Management Directors voted in favor. Klaassen abstained.

K. Post-November 1 Events

After the meeting, Klaassen consulted with counsel, but he otherwise appeared to accept his termination. Hood and Klaassen even had a brief honeymoon period during which Klaassen helped Hood adjust to the CEO position. The Board delayed any public or Company-wide announcement regarding Klaassen's termination, and Hood encouraged Klaassen to write his own script for the change. Hood hoped Klaassen would join him in pitching the transition as a natural progression that would enable Klaassen to devote less time to operations and spend more time as a corporate visionary.

During the weeks after his termination, Klaassen negotiated a consulting agreement with Allegro that would govern his new role as "Chairman and Founder." The discussions broke down over how many hours Klaassen would work and what he would be paid. Klaassen never asserted during this time that the termination was invalid or that he remained CEO.

In late November, Klaassen began to undermine Hood and his new management team. On November 29, 2012, Klaassen sent a late-night email to ExxonMobil, a major Allegro customer, saying that Allegro had "become a very dysfunctional company," that there was a "bitter dispute between shareholders," that he was unable to "insulate [Allegro's] customers from this conflict," and that he "deeply regret[ted] the negative impact that [the dispute would] have on projects" at Exxon. JX 408. Exxon contacted Hood and placed Allegro on its "risk watch list" for vendors. JX 421. Hood reminded Klaassen that "in your capacity as a member of the Allegro Board of Directors, you need

to act to promote the Company's interest, not tear us down." JX 423. Klaassen accepted the admonition. He did not object that he—not Hood—was really the CEO.

Klaassen also began hosting events for Allegro employees, including happy hours, lunches, and dinners. During these gatherings, Klaassen criticized new management and spread rumors that terminations were afoot. Paraphrasing Twain, Klaassen also suggested that the rumors of his demise were greatly exaggerated, but he appears to have anticipated retaking the reins as part of a buyout of the Series A Investors, not because the Board had never terminated him properly in the first place.

Using his position as a director, Klaassen demanded extensive information from the Company. He scrutinized Hood's actions and "insisted" as a "director and shareholder" that he would hold Hood accountable as CEO. Klaassen questioned or opposed numerous policy proposals, even relatively uncontroversial matters like Ducanes's request that the Board convert to using electronic board materials to streamline the record keeping process. As a member of the Audit Committee, he accused Allegro's new management of fraud and embezzlement. There had been no changes in accounting treatment or methodology since Klaassen's departure, and the auditors found no evidence of wrongdoing. These accusations were an expensive and distracting sideshow.

During this time, Klaassen continued to solicit the Series A Investors' interest in selling their shares, eventually upping his offer to $62.5 million. The Series A Investors declined. By early March, Klaassen realized that he would not be able to reach a deal with the Series A Preferred within the range of values he was willing to pay.

L. Klaassen Delivers The June 2013 Consent And Files Suit.

By letter dated June 5, 2013, seven months after his termination, Klaassen took the position that he remained CEO. In his alleged capacity as CEO, he purported to remove Hood and Simpkins without cause. Klaassen also delivered a written consent to the Company that purported to remove Hood and Simpkins as Outside Directors and fill the resulting vacancies with non-parties Dave Stritzinger and Ram Velidi. JX 518 (the "June 2013 Consent"). The June 2013 Consent filled the Common Director seat with non-party John Brown. *Id.* That same day, Klaassen filed this action pursuant to Section 225 of the DGCL.

II. LEGAL ANALYSIS

This court must determine (i) whether the Board validly removed Klaassen from his position as CEO on November 1, 2012, and (ii) whether and to what degree the June 2013 Consent validly effected corporate action. The parties advance certain arguments about the June 2013 Consent that turn on whether Klaassen remained CEO, making the former determination a predicate to the latter analysis.

A. The Effectiveness Of Klaassen's Removal As CEO

Klaassen challenges his removal as CEO on two separate grounds. First, he argues that in deciding to replace him, a majority of the directors breached their duty of loyalty, including the subsidiary element of good faith. According to Klaassen, the Series A Directors expected to exit within five years with a minimum return of two times their investment. In 2012, neither a redemption nor a liquidation event offered a viable path to achieving a 2x return, so their only option was to convince Klaassen to buy them out.

When Klaassen refused to meet their demand, the Series A Directors tried to play hardball by firing him, expecting Klaassen would capitulate when faced with no longer being CEO of the company he founded and ran for 29 years. Klaassen contends that the Series A Directors acted disloyally and in bad faith because they used "their position of trust and confidence to further their private interests."[5] He also claims that they bought Hood's vote with the CEO position. Calling into question the loyalties of three of the five directors would rebut one of the elements of the business judgment rule and change the standard of review to entire fairness. *See Disney II*, 906 A.2d at 52 (explaining that

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[5] *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *accord Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006); *In re Walt Disney Co. Deriv. Litig.* ("*Disney II*"), 906 A.2d 27, 67 (Del. 2006) ("A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation."); *see also Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (Allen, C.) (defining a "bad faith" transaction as one "that is authorized for some purpose other than a genuine attempt to advance corporate welfare or is known to constitute a violation of applicable positive law"); *In re RJR Nabisco, Inc. S'holders Litig.*, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) (Allen, C.) (explaining that the business judgment rule would not protect "a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation's best interests"). According to Klaassen, the Series A Directors acted in bad faith when they fired him because they were seeking consciously to extract the most value for the Series A Preferred rather than attempting to maximize the value of the corporation as a whole for the benefit of its residual holders, *viz.* the common stock and other providers of equity capital, without reference to any special contractual rights. *See LC Capital Master Fund, Ltd. v. James*, 990 A.2d 435, 452 (Del. Ch. 2010) ("[I]t is the duty of directors to pursue the best interests of the corporation and its common stockholders, if that can be done faithfully with the contractual promises owed to the preferred."); *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1042 (Del. Ch. 1997) (Allen, C.) ("[G]enerally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock—as the good faith judgment of the board sees them to be—to the interests created by the special rights, preferences, *etc.*, of preferred stock . . . ."); *see also Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 182 (Del. 1986) ("[T]he Revlon board could not make the requisite showing of [fiduciary] good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract.").

the business judgment rule can be rebutted by establishing that "the directors breached their fiduciary duty of care or of loyalty or acted in bad faith" and that "[i]f that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders"). Klaassen contends that the defendants cannot show that his termination was entirely fair. Consequently, he argues, this court should deem the Board's actions invalid.

Second, Klaassen argues that the actions taken at the November 1 meeting were invalid, even if they complied with the DGCL and the Charter and Bylaws, even if the Non-Management Directors complied with their fiduciary duties, and even if a court were to determine that the outcome was entirely fair. This is true, Klaassen says, because four decisions of this court supposedly establish a special equitable notice requirement for an officer who is also a director and who can exercise a right that could potentially change the composition of the board. Klaassen contends that a board cannot take action adverse to the interests of such an individual unless the board provides him with advance notice and an opportunity to pre-empt the board by changing its composition. An individual with this combination of capacities and rights becomes a super director whose authority trumps Section 141(a) of the DGCL. Because the Board did not respect his special equitable right to notice and permit him to exercise his hybrid superpowers, Klaassen claims his termination is invalid.[6]

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[6] In support of this theory, Klaassen relies on *Fogel v. U.S. Energy Sys., Inc.*, 2007 WL 4438978 (Del. Ch. Dec. 13, 2007); *Adlerstein v. Wertheimer,* 2002 WL 205684 (Del. Ch. Jan. 25, 2002); *VGS, Inc. v. Castiel,* 2000 WL 1277372 (Del. Ch. Aug. 31, 2000), *aff'd*, 781 A.2d 696

The defendants dispute each of Klaassen's theories. More importantly, they raise powerful equitable defenses. This decision does not rule on Klaassen's theories because, assuming for the sake of argument that they are valid, the equitable defenses of laches and acquiescence bar his claims.

(Del. 2001) (ORDER); and *Koch v. Stearn,* 1992 WL 181717 (Del. Ch. July 28, 1992). Here, the affirmative defenses dispose of the case, so this decision need not grapple with these four opinions. I note only that Klaassen's interpretation would create substantial tension with the DGCL's director-centric system of corporate governance. *See, e.g.*, *McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000) ("One of the fundamental principles of the Delaware General Corporation Law statute is that the business affairs of a corporation are managed by or under the direction of its board of directors."); *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291-92 (Del. 1998) ("One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. . . . Section 141(a) . . . confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation.") (emphasis in original) (internal 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)"). Klaassen also has not recognized that the Delaware Supreme Court vacated the decision in *Koch*, thereby depriving *Koch* of precedential effect. *See Stearn v. Koch*, 628 A.2d 44, 46-47 (Del. 1993); s*ee also 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 . . . ."); *Tyson Foods, Inc. v. Aetos Corp.*, 818 A.2d 145, 148 (Del. 2003) (noting that the federal vacatur standard is in "harmony with Delaware's standard"). *Fogel* and *Adlerstein* each relied on *Koch* without taking into account that the decision was vacated. The *VGS* decision involved an LLC and appears to turn on the court's understanding of unique features of the LLC agreement in that case. In short, it is not clear to me that Klaassen otherwise would prevail under his interpretation of the *Koch* line of authority.

1. The Availability Of Equitable Defenses

To head off any equitable defenses, Klaassen argues that the Board's actions were void and therefore cannot be validated in equity. In my view, because Klaassen seeks to invalidate the Board's actions by invoking principles of equity, his theories are subject to equitable defenses. Put differently, the Board's actions were voidable, not void.

Support for the principle that void acts cannot be validated comes from the Delaware Supreme Court's decision in *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991). In its post-trial decision in that litigation, this court applied the doctrine of equitable estoppel to hold that shares issued in violation of the corporation's certificate of incorporation were valid. *Waggoner v. STAAR Surgical Co.*, 1990 WL 28979 (Del. Ch. Mar. 15, 1990), *rev'd*, 588 A.2d 1130 (Del. 1991). On appeal, the high court reversed on the grounds that a "court cannot imbue void stock with the attributes of valid shares." *STAAR Surgical*, 588 A.2d at 1137; *see also Waggoner v. Laster*, 581 A.2d 1127, 1137 (Del. 1990) ("Estoppel, however, has no application in cases where the . . . action approved by the directors or stockholders is illegal or void."). In cases involving statutory violations, this court has generally followed *STAAR Surgical*'s teachings and declined to rely on equitable doctrines to validate otherwise void acts.[7] In light of the

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[7] *See, e.g.*, *Blades v. Wisehart*, 2010 WL 4638603, *10-12 (Del. Ch. Nov. 17, 2010) (holding that stock purportedly issued through a stock split that did not comply with § 242 of the DGCL was "void and a nullity"); *Liebermann v. Frangiosa*, 844 A.2d 992, 1004 (Del. Ch. 2002) ("[O]ur case law has refused to overlook the statutory invalidity of stock even in situations when that might generate an inequitable result."); *Superwire.com, Inc. v. Hampton*, 805 A.2d 904, 909 n.17 (Del. Ch. 2002) (rejecting equitable defenses on the grounds that the court "cannot give *any* effect to void shares even in the context of an equitable defense." (emphasis in original)).

difficulties created by the doctrine of incurable voidness, the General Assembly recently amended the DGCL to establish a statutory procedure by which this court could establish the validity of otherwise void corporate acts. *See* 8 *Del. C.* § 204.

Void acts contrast with voidable acts, which can be ratified or validated in equity. *See Michelson v. Duncan*, 407 A.2d 211, 19 (Del. 1979) ("[V]oidable acts are susceptible to cure by shareholder approval while void acts are not."); *see also Nevins v. Bryan*, 885 A.2d 233 (Del. Ch.) (holding that the challenged actions were voidable and that the plaintiff's challenge was barred by equitable defenses), *aff'd*, 884 A.2d 512 (Del. 2005). As the Delaware Supreme Court has explained, "[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*, 407 A.2d at 218-19; *accord Solomon v. Armstrong*, 747 A.2d 1098, 1114 (Del. Ch. 1999) ("Void acts are those acts that the board, or more generally the corporation, has no implicit or explicit authority to undertake or those acts that are fundamentally contrary to public policy.").

Delaware decisions on improperly noticed board meetings pre-date *Michelson* by over sixty years. The first three Court of Chancery decisions to address improper notice involved situations where either (i) the notice required by the bylaws was not given at all or (ii) notice had to be given in a particular manner and the requirements were not followed. In each case, this court described the actions taken at the improperly noticed

meeting as "invalid," "illegal," or "void."[8] The opinions did not explore whether the acts were voidable or consider ratification or equitable defenses.

More recently, but still before *Michelson*, this court issued its decision in *Schroder v. Scotten, Dillon Co.*, 299 A.2d 431 (Del. Ch. 1972), a case that concerned the validity of actions taken at two special board meetings. For the first meeting, purportedly held on December 13, 1971, notice was not given to one member of the board, and that director failed to attend. This presented a straightforward application of the established rule, and the opinion described the acts taken as "void." *See id.* at 435 ("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."). For the second meeting, purportedly held on December 23, the same member of the board again claimed not to have received notice, but the court inquired more deeply into the facts. Finding that "if he did not [receive notice], it was only because he refused to accept the two registered letters by which notice was sent," the court held that "[o]ne cannot [willfully] avoid receiving notice and then claim that he had none." *Id.* at 436. Had the analysis stopped there, it appears that court would have excused the technical lack of notice and declined to invalidate the

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[8] *See In re Seminole Oil & Gas Co.*, 1958 WL 55434, at *1 (Del. Ch. July 30, 1958) (Seitz, C.) (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 v. Nat'l Guar. Credit Corp.*, 116 A. 738, 740 (Del. Ch. 1922) (Wolcott, C.) ("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 v. Kehoe Stenograph Co.*, 95 A. 895, 898 (Del. Ch. 1915) ("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.").

actions taken at the meeting. But the court delved into the facts even further, noting that the absent director also asserted (i) that the Chairman had told him the meeting would be postponed until December 29 and (ii) that the director relied on that representation in failing to attend. Because the Chairman did not dispute this account, the court held that the director's absence was procured by the Chairman's representation. *Id.* This finding in turn caused the actions taken at the December 23 meeting to be invalid:

> 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). The *Schroder* decision thus ultimately deemed the actions taken at the second meeting meetings to be "void," but only after considering the equities.

Even after *Michelson*, Delaware decisions addressing improperly noticed board meetings typically have not asked whether the actions taken were voidable rather than void, nor have they applied the *Michelson* test. Most prominently in the *Koch* line of cases, this court has invalidated board meetings on equitable grounds while relying on pre-*Michelson* decisions for the principle that actions taken at an improperly noticed board meeting are "void."[9] The cases did not consider whether the acts instead could be voidable.

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[9] *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

Since *Michelson*, two decisions from this court have addressed the void-versus-voidable distinction. In *Moore Business Forms, Inc. v. Cordant Holdings Corp.*, 1998 WL 71836 (Del. Ch. Feb. 4, 1998), a board of directors intentionally did not give a director affiliated with a large preferred stockholder prior notice of a special board meeting on August 23, 1994, at which the board voted to terminate an agreement with the preferred stockholder. *Id.* at *7. One month later, on September 27, the board held a special meeting with the preferred stockholder's designee in attendance and purported to ratify the termination. *Id.* at *8. Citing *Schroder*, this court held that the failure to give notice of the August 23 special meeting as required by the bylaws rendered the actions taken at the meeting "void." *Id.* at *7. Turning to the question of ratification under *Michelson*, the court noted that the actions taken at the August 23 special meeting were not traditional void acts, such as decisions that were "*ultra vires*, a gift, or waste." *Id.* at *9. Moreover, there was no dispute that but for the failure to give notice to the preferred stockholder's designee, the board had authority to terminate the agreement. Nevertheless, the court held that the bylaw violation rendered the actions taken at the August 23 meeting void rather than voidable and hence not subject to ratification. *Id.*

In *Nevins*, this court again addressed the question of whether board action taken at an improperly noticed meeting were voidable rather than void such that they could be ratified. 885 A.2d at 246. The board in *Nevins* held a series of meetings after the

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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).

corporation's executive director, who also was a board member, was arrested unexpectedly. During those meetings, the board reviewed the circumstances of the arrest, considered other alleged improprieties by the executive director, including misuse of company funds, and took action to expand the board. The executive director did not receive notice of and did not attend a meeting that occurred while he was in custody. He also did not receive notice of or attend two later meetings that took place in August 2001 after his release. He did receive notice of a meeting on September 12, but could not attend because he had to appear at a hearing in his criminal case. At that meeting, the board ratified all decisions taken during the previous three months. On October 3, the board removed the executive director at a duly noticed meeting that the executive director attended.

One year later, the ousted executive director filed a Section 225 action challenging his removal, claiming that certain actions were void because they were taken at meetings that he did not receive notice of, that those actions could not have been ratified on September 12, and that because those actions were void, his removal was invalid. Applying *Michelson*, this court held that

> all of the disputed corporate actions [taken at the challenged meetings] lawfully could have been accomplished by the Defendants had they done them in the appropriate manner, *i.e.*, had they given proper notice of the meeting. These actions were in the interest of [the corporation] and did not constitute *ultra vires* acts, fraud or corporate waste. . . . Therefore, the corporate actions at issue were voidable actions susceptible to cure by member approval and to the defense of estoppel.

Id. at 246 (footnote omitted); *see also Lofland v. DiSabatino*, 1991 WL 138505 (Del. Ch. July 25, 1991) (holding that defective notice of annual meeting rendered director election voidable, not void).

Having determined that the executive director's claims were subject to equitable defenses, this court barred him from contesting the validity of the board's actions or his removal under the equitable doctrines of acquiescence, laches, and equitable estoppel. *Nevins*, 885 A.2d at 246-50. The principal distinction between *Nevins* and earlier cases appears to be the court's view that the executive director was mounting an equitable challenge, making him subject to the equitable principle that "he who seeks equity must do equity" and permitting equitable defenses to be invoked. *Id.* at 248.

Consistent with *Nevins*, this court held in another case that a special board meeting was validly called under the principle that equity "regards that as done which in good conscience ought to be done." *Hockessin Cmty. Ctr., Inc. v. Swift*, 59 A.3d 437, 462 (Del. Ch. 2012) (quoting *Monroe Park v. Metro. Life Ins. Co.*, 457 A.2d 734, 737 (Del. 1983)). The lone director indisputably lacked the authority under the bylaws to call and notice the special meetings, but he took those steps only after asking the President to exercise his authority to convene the board. This court held that the President "should have called a special meeting," found that all directors received actual notice of the special meeting and were able to attend, and ruled that the meeting was validly convened.

> Under these circumstances, I find that the May 24 meeting was validly called, convened, and conducted. If [the President] had called a special meeting promptly, as Swift requested, then a majority of the directors could have taken action at that meeting, or they could have scheduled another meeting, a series of meetings, or the annual meeting. To fail to recognize

> the May 24 meeting as valid would legitimize [the President's] decision to decline to call a special meeting. His dereliction of duty would become a veto over Board action. The business and affairs of a Delaware corporation are governed by its board of directors, not the Board President. *See* 8 *Del. C.* § 141(a). [The President's] authority as an officer was subordinate to the Board's authority. In his capacity as President, Cammock was an agent of the corporation, and he had a duty to carry out the decisions of the Board. It would elevate the President's authority as an officer and agent above the Board's authority as principal and authorized decision-maker to permit the President to incapacitate the Board by declining to call a special meeting.

Id. at 462-63.

The foregoing authorities suggest 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.[10] 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] It also recognizes that

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[10] Admittedly, the case law in this area has not always been consistent, and some cases apply equitable defenses even if a bylaw was violated. The line I have drawn 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) is the best I can do to harmonize the decisions into a workable rule. It necessarily represents one trial judge's effort and may not accurately reflect Delaware law.

[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 Int'l, Inc. v. Black*, 844 A.2d 1022, 1080 n.136 (Del. Ch. 2004) ("[B]ylaws may pervasively and strictly regulate the

traditionally, when a board took action in contravention of a mandatory bylaw, the board action was treated as void.[12]

Klaassen does not contend that the Board violated a mandatory bylaw. He invokes equity. Consequently, assuming for the sake of argument that Klaassen proved that he was entitled to relief under either of the equitable theories that he asserts, his claims would be subject to the Non-Management Directors' equitable defenses.

2. Laches

"The equitable defense of laches is based on the theory that upon a person's acquiring knowledge of a wrong affecting his rights, any unreasonable delay in asserting an equitable remedy will bar such form of relief." *Skouras v. Admiralty Enters., Inc.*, 386 A.2d 674, 682 (Del. Ch. 1978) (citations omitted). "The doctrine of laches recognizes that equity does not aid those who slumber on their rights; therefore, a party seeking equitable relief may need to file with greater alacrity than is required by the analogous statute of limitations to preserve its entitlement to relief . . . ." *In re Sirius XM S'holder*

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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.]"); William J. Grange, *Corporate 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."); Seymour D. Thompson & Joseph W. Thompson, 2 *Commentaries on the Law of Corporations* § 1280 (3d ed. 1927) (explaining ability of bylaws to bind board of directors).

Litig., 2013 WL 5411268, at *4 (Del. Ch. Sept. 27, 2013) (footnotes omitted). "Thus, laches may bar a plaintiff in equity before the analogous statute of limitations has run . . . ." *Id.*; *accord U.S. Virgin Islands v. Goldman, Sachs & Co.*, 937 A.2d 760, 808 (Del. Ch. 2007) ("[T]he doctrine of laches also permits this court to hold a plaintiff to a shorter period [than the analogous statute of limitations] if, in terms of equity, the plaintiff should have acted with greater alacrity, and when the plaintiff's failure to seek equitable relief with alacrity threatens prejudice to the other party."), *aff'd*, 956 A.2d 32 (Del. 2008) (ORDER).

"The defense of laches normally requires a showing by a defendant that (a) plaintiff knew (or should have known) of its rights or claim; (b) plaintiff failed to assert its rights or claim; and (c) defendant has materially changed its position or otherwise materially relied on plaintiff's failure to assert." *Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 714 A.2d 96, 104 (Del. Ch. 1998), *aff'd in relevant part*, 817 A.2d 160 (Del. 2002). In the Section 225 context, a delay of even a month and a half has been held sufficient to bar a claim under the doctrine of laches. *See Stengel v. Rotman*, 2001 WL 221512 (Del. Ch. Feb. 26, 2011). The reasons for the delay are more critical than the amount of time that has elapsed. *Whittington v. Dragon Gp. L.L.C.*, 2009 WL 1743640, at *6 (Del. Ch. June 11, 2009).

Here, Klaassen fully understood his rights under the Charter, Bylaws, and Stockholders' Agreement, and he knew the material facts surrounding his removal and Hood's appointment. As founder, director, and CEO, he was familiar with Allegro's constitutive documents, and he was a party to the Stockholders' Agreement. At the time

of his removal, he already had obtained legal advice about his rights as CEO both from the Company's General Counsel and from Gibson Dunn, and within hours after the November 1 meeting, Klaassen sought legal advice from his personal counsel. Despite his knowledge, Klaassen failed to assert any claims for seven months.

It is true that during the intervening period, Klaassen tried to negotiate a buyout with the Series A Investors, but those negotiations broke down in early 2013, and Klaassen still did not bring suit. Klaassen has provided no valid explanation for this delay.

Meanwhile, Hood began managing the Company, assembled a new executive team, instituted new policies, and made commitments to Allegro's employees and customers. If Klaassen had sued earlier, the Non-Management Directors could have anticipated his potential reinstatement as CEO and planned accordingly. At this late date, Klaassen's return would throw Allegro into chaos. Although Klaassen has committed to assessing each of the new hires, it is hard to imagine, given the claims he has made in this litigation, that Klaassen would retain many of them. In addition, Allegro's relationships with its customers, some of whom have relied on representations made by the new team, would be threatened. Allegro has been prejudiced by Klaassen's months of unreasonable delay, and the doctrine of laches bars his claims.

3. Acquiescence

Klaassen's claims also are barred under the doctrine of acquiescence. This doctrine applies when a plaintiff "has full knowledge of his rights and the material facts and (1) remains inactive for a considerable time; *or* (2) freely does what amounts to

recognition of the complained of act; *or* (3) acts in a manner inconsistent with the subsequent repudiation, which leads the other party to believe the act has been approved." *NTC Gp., Inc. v. West-Point Pepperell, Inc.*, 1990 WL 143842, at *5 (Del. Ch. Sept. 26, 1990) (emphasis added). As the disjunctive framing indicates, a defendant need only establish one of the bases for acquiescence. Thus, although to remain inactive for a considerable period of time evidences acquiescence, a lengthy delay is not required, and acquiescence "may bar a party . . . in a very short period." *Papaioanu v. Comm'rs of Rehoboth*, 186 A.2d 745, 749 (Del. Ch. 1962) (quoting Henry M. Herman, *Commentaries on the Law of Estoppel and Res Judicata* 1191 (1886)). Acquiescence does "not require a showing of change of position or prejudice." *Id.*

As discussed above, Klaassen had full knowledge of his rights and the material facts surrounding his removal on November 1, yet he subsequently took numerous actions that necessarily conceded the validity of his termination. These included:

- Helping Hood learn about the ETRM industry to enable Hood to act knowledgeably as CEO and giving Hood advice on dealing with employees and customers;
- Asking Hood to provide a draft of a stay-on contract under which Klaassen would serve as a consultant to Allegro, obtaining legal advice on the proposed consulting agreement, and negotiating the terms of the proposed consulting agreement;
- Approving drafts of the proposed consulting agreement that included language barring Klaassen from holding himself out as an Allegro employee;
- Approving drafts of the proposed consulting agreement that identified Hood as Allegro's "President & CEO" and required Klaassen to "report to and follow the lawful directives of Allegro's CEO";
- Objecting that Hood, as CEO, could not serve on the Audit Committee;

- Signing a unanimous written consent in lieu of Board action at a meeting appointing Klaassen to the Audit and Compensation Committees and removing Hood from the Audit Committee because of Hood's status as an officer of Allegro;

- Sending emails asking the other directors to execute and return the written consent appointing Klaassen to the Audit and Compensation Committees and removing Hood from the Audit Committee;

- Following up with Ducanes to check if the other directors had signed and returned the written consent appointing Klaassen to the Audit and Compensation Committees and removing Hood from the Audit Committee;

- Providing comments on Hood's employment agreement, including feedback on the provisions governing Hood's potential bonus;

- Voting at meetings of the Compensation Committee as a member of the committee, which he could not do under the Bylaws if he continued to be CEO;

- Interviewing and approving proposed additions to Hood's management team in his capacity as a member of the Compensation Committee; and

- Sending an email to Simpkins discussing the "management change" and stating that, "[a]s a director and shareholder," he planned to hold Hood accountable for Allegro's performance.

Taken together, these actions amount to acquiescence.

Admittedly, Klaassen took some actions that expressed his displeasure with his removal and replacement, but in the context of Klaassen's actions as a whole, his expressions of displeasure were not sufficient to defeat an acquiescence defense. *See Nevins*, 885 A.2d at 243, 246-48 (noting that Nevins made it clear that he was "displeased by the Board's decisions," but holding that he nonetheless acquiesced in those decisions). Klaassen's overall conduct made it reasonable for the defendants to believe that he had accepted the validity of his removal and Hood's installation as CEO. Klaassen cannot turn around and dispute their actions now.

B. The Effectiveness Of The June 2013 Consent

For the reasons discussed in the previous section, Klaassen cannot contest his removal as CEO, meaning that the defendants have prevailed on the first major issue in the case. The second major issue is the extent to which the June 2013 Consent changed the composition of the Board.

To review the governance structure, Article II, Section 2 of the Bylaws sets the number of directors at seven and states that "[t]he composition of the Board of Directors shall be established as set forth in the Certificate of Incorporation and Section 9 of the Stockholders Agreement." JX 12 Art. II § 2(a). Section 3.3.1 of the Charter creates three special seats for the Series A Directors and one for the Common Director. JX 11 § 3.3.1. The balance of the seats are for the Remaining Directors, who are elected by the holders of all outstanding shares of stock voting together as a single class "in accordance with the terms of Section 9.2 of that certain Stockholders' Agreement . . . ." *Id.* Section 9.2 of the Stockholders' Agreement divides the Remaining Directors into the CEO Director and the Outside Directors. JX 10 § 9.2. Unlike the Series A Directors and the Common Director, the positions for the CEO Director and the Outside Directors do not appear in the Charter. Only the Stockholders' Agreement establishes those categories.

Under this governance structure, the Charter and Bylaws allocate various rights to the different classes of stockholders, then the Stockholders' Agreement adds a contractual overlay that constrains the manner in which parties to that agreement can exercise their rights. As the holder of a majority of Allegro's voting power, Klaassen possesses rights

under the Charter and Bylaws to elect directors, remove directors, and fill vacancies that he agreed not to exercise in the Stockholders' Agreement.

The June 2013 Consent purported to fill the Common Director seat with Brown, remove Simpkins and Hood from their Outside Director seats, and fill the resulting vacancies with Stritzinger and Velidi. For the reasons next discussed, the June 2013 Consent succeeded only in electing Brown and removing Simpkins.

1. Brown

Whether Klaassen could fill the Common Director seat with Brown depended on whether that seat was vacant. Klaassen assumed that it was and did not remove anyone from the seat before filling the vacancy. The defendants assumed that since November 1, 2012, Klaassen occupied the Common Director seat. Klaassen was correct.

Until his termination as CEO, Klaassen served in the Remaining Director seat allocated in the Stockholders' Agreement to the CEO Director. After the Board terminated him as CEO, Klaassen continued to serve as a director because no one ever removed him and he never resigned. For purposes of the Charter and Bylaws, he continued as one of the Remaining Directors. For purposes of the Stockholders' Agreement, he could no longer qualify as the CEO Director, nor could he meet the definition of an Outside Director, which requires that the Outside Directors be "neither Stockholders nor Affiliates of any Stockholder of the Corporation." JX 10 § 9.2(d). This meant that any of the parties to the Stockholders' Agreement could have exercised a contractual right to insist that Klaassen be removed from the Board, but no one ever did. If they had, then Klaassen doubtless would have exercised his voting power as the holder

of virtually all of the outstanding common stock to fill the Common Director vacancy with himself. It comes as no surprise that no one confronted him about his status.

For purposes of the present litigation, however, it matters that Klaassen continued as a Remaining Director, because this means that the Common Director seat was vacant when Klaassen delivered the June 2013 Consent. By virtue of the June 2013 Consent, Brown became the Common Director. Klaassen continues as a Remaining Director, albeit one who cannot meet the requirements of the Stockholders' Agreement.

Klaassen's continuing status as a director flows from the locations of the various director designations in Allegro's corporate governance documents. This court has held that if a clear, self-executing qualification for board membership appears in the certificate of incorporation, and if a director serving in a seat subject to the qualification no longer meets it, then the director is no longer qualified and ceases to be a director in a manner "akin to a resignation." *See Stroud v. Milliken Enters.*, 585 A.2d 1306, 1309 (Del. Ch. 1988), *appeal dismissed*, 552 A.2d 476 (Del. 1989). Under *Stroud*, if the CEO Director seat appeared in the Charter, then Klaassen would have ceased to serve as a director when the Board terminated him as CEO.

By contrast, if the Bylaws had designated a directorship for the CEO, then the result would be the same as in the current case. This court has held that a bylaw provision cannot "impose a requirement that would disqualify a director and terminate his service." *Kurz v. Holbrook*, 989 A.2d 140, 157 (Del. Ch.), *rev'd on other grounds*, *aff'd in part sub nom. Crown EMAK P'rs, LLC v. Kurz*, 992 A.2d 377 (Del. 2010); *accord Rohe v. Reliance Training Network, Inc.*, 2000 WL 1038190, at *11-12 (Del. Ch. July 21,

2000). The statutory authorization for director qualification provisions in the bylaws "contemplates reasonable qualifications to be applied at the front end, before a director's term commences, when the director is 'elected and qualified.'" *Kurz*, 989 A.2d at 157 (quoting 8 *Del. C.* § 141(b)); *accord Triplex Shoe Co. v. Rice & Hutchins, Inc.*, 152 A. 342, 351 (Del. 1930) (holding that bylaw requiring director to be a stockholder mandated stock ownership when entering office). Otherwise a board of directors holding the customarily granted authority to "adopt, amend or repeal bylaws," 8 *Del. C.* § 109(a), could adopt bylaw qualifications for directors that could operate to remove their fellow directors, a result Delaware law does not permit.[13] If the qualification appeared in the

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[13] *See Kurz*, 989 A.2d at 157 ("For 89 years, Delaware law has barred directors from removing other directors."); *Nevins*, 885 A.2d at 252 n.70 ("Delaware law does not permit directors to remove other directors."); *Solstice Capital II, Ltd. P'ship v. Ritz*, 2004 WL 765939, at *1 (Del. Ch. Apr. 6, 2004) (holding that an "attempt to remove . . . a director by written consent of the board is invalid"); *Stroud*, 585 A.2d at 1309 ("Generally, directors do not have power under Delaware law to remove fellow directors."); *Bruch*, 116 A. at 741 ("I am of the opinion that directors of an industrial corporation, such as was the defendant, cannot be removed by his fellow members. A director is an officer chosen by the stockholders. His title to the office is as good as the title of his fellows. His right to the office is quite different from that of those officers of the corporation who are selected not by stockholders but by the directors themselves. If the power of amotion of a director exists, it is reasonable to hold that it shall be exercised by the power that elected him, *viz.* by the stockholders."); *see also Dillon v. Berg*, 326 F. Supp. 1214, 1225 (D. Del.) ("To allow the Board to remove one of its own members at any time without cause would seem to be completely violative of shareholder rights. . . . In the opinion of this Court such a provision would violate 8 *Del. C.* § 211 *et seq*. and the public policy of the State of Delaware and would thus be void and unenforceable."), *aff'd*, 453 F.2d 876 (3d Cir. 1971) (per curiam). *See generally* S. Samuel Arsht & Lewis S. Black, *The 1974 Amendments to the Delaware Corporation Law* 378 (1974) (explaining that when the stockholders' power to remove directors was confirmed and addressed through the adoption of Section 141(k), it established "by negative implication intended by the draftsmen, directors do not have power to remove other directors"); 1 R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations and Business Organizations* § 4.4 at 4–15 (3d ed. 2013) ("While stockholders may remove directors for cause, it is highly doubtful whether directors, as opposed to stockholders, may be empowered by either the certificate of incorporation or by-laws to remove a director for cause."); Robert Penington, *Penington on Delaware Corporations* 117

Bylaws, then Klaassen's failure to continue to qualify as CEO would not have affected his continuing status as a director.

In this case, the CEO Director seat appeared in the Stockholders' Agreement. Klaassen therefore continued to serve as a director, and for purposes of the Charter and Bylaws he was one of the Remaining Directors. The Common Director seat was vacant, and the June 2013 Consent validly filled it with Brown.

2. Hood And Simpkins

In the June 2013 Consent, Klaassen purported to remove Hood and Simpkins without cause. He only succeeded in removing Simpkins.

Section 141(b) of the DGCL provides that "[e]ach director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal." 8 *Del. C.* § 141(b). "Section 141(b) [thus] recognizes three procedural methods by which the term of a sitting director can be brought to a close: first, where the director's successor is elected and qualified; second, if the director resigns, or third; if the director is removed." *Crown EMAK*, 992 A.2d at 400.

Section 141(k) of the DGCL establishes the default rule that "[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors." 8 *Del. C.* § 141(k). The default rule is subject to two exceptions, neither of which applies in this

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(1925) ("A director being an officer chosen by the stockholders cannot be removed by his fellow directors.").

case. *See* 8 *Del. C.* § 141(k)(1)-(2). Consequently, as to the Remaining Directors, stockholders holding a majority of the outstanding voting power entitled to vote in an election of directors could remove any Remaining Director with or without cause. 8 *Del. C.* § 141(k); *Rohe*, 2000 WL 1038190, at *11 ("Section 141(k) provides no limitation on the right of stockholders to remove a member of a non-classified board."). As to the Series A Directors and the Common Director, stockholders holding a majority of the outstanding voting power of the Series A Preferred or common stock, respectively, could remove their special directors with or without cause. 8 *Del. C.* § 141(k). Stockholders holding a majority of the outstanding voting power entitled to vote in an election of directors could remove a Series A Director or the Common Director only with cause.[14]

Allegro's Bylaws attempt to authorize removal only for cause and to limit removal without cause to action taken in compliance with the Stockholders' Agreement. Article II, Section 10 states: "Any or all of the directors may be removed, with cause, by the holders of a majority of the shares of stock outstanding and entitled to vote for the election of directors. Directors may only be removed without cause as provided for in Section 9.4 of the Stockholders Agreement." JX 12 Art. II § 10. To the extent a bylaw

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[14] *See id.*; *Roven v. Cotter,* 547 A.2d 603, 605 (Del. Ch. 1988) ("Delaware courts have always recognized the inherent power of stockholders to remove a director for cause.") (citations omitted); *Campbell v. Loew's, Inc.*, 134 A.2d 852, 858 (Del. Ch. 1957) (Seitz, C.) (concluding before adoption of Section 141(k) "that as a matter of Delaware corporation law the stockholders do have the power to remove directors for cause"); Arsht & Black, *supra*, at 378 ("[Section 141(k)] answers the most frequently asked question by expressly granting to the stockholders broad authority to remove directors with or without cause, in most cases, and for cause in all cases."); Balotti & Finkelstein, *supra*, § 4.4 at 4-9 to 4-12 (explaining the stockholders' right to remove directors for cause is absolute under Delaware law).

conflicts with the DGCL or the certificate of incorporation, it is invalid. *See* 8 *Del. C.* § 109(b) (providing that the "bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees"); *Crown EMAK*, 992 A.2d at 398 ("[A] bylaw provision that conflicts with the DGCL is void."). Nevertheless, "[t]he bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws." *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985).

By purporting to provide that removal without cause can occur only "as provided for in Section 9.4 of the Stockholders Agreement," Article II, Section 10 potentially conflicts with Section 141(k) and the Charter. If Allegro stockholders who were not parties to the Stockholders' Agreement sought to remove one or more Remaining Directors without cause, the bylaw purportedly would restrict their statutory and Charter-based rights. To avoid the conflict, I read the bylaw as stating that to the extent stockholders *who are parties to the Stockholders' Agreement* seek to remove directors, they must comply with the Stockholders' Agreement's terms.

Klaassen is a party to the Stockholders' Agreement. By entering into the Stockholders' Agreement, Klaassen agreed voluntarily not to exercise his power as holder of a majority of the corporation's outstanding voting power to remove the Remaining Directors without cause. In Section 9.4 of the Stockholders' Agreement, Klaassen and the other parties to the agreement committed "to vote, or cause to be voted,

all Shares owned by such Stockholder, or over which such Stockholder has voting control, from time to time and at all times, in whatever manner as shall be necessary" such that, subject to two exceptions, no director elected pursuant to the Stockholders' Agreement "may be removed from office other than for cause." JX 10 § 9.4(a). To reiterate, even though Klaassen otherwise could remove a director without cause, he agreed in the Stockholders' Agreement not to do so unless one of two exceptions applies.

The first exception permits a party to the Stockholders' Agreement to act to remove a director without cause if "such removal is directed or approved by the affirmative vote of the Person, or of the holders of a majority of the shares of Capital Stock, entitled under Section 9.2 to designate that director." *Id.* Thus if a majority of the holders of the Series A Preferred directed or approved the removal of one or more Series A Directors, or if the holder of a majority of the common stock directed or approved the removal of the Common Director, then any party to the Stockholders' Agreement could exercise the right it otherwise held under the Charter and Bylaws to seek to remove the director without cause.

Section 9.2(d) provides that the two Outside Directors are "designated by the Company's Chief Executive Officer." *Id.* § 9.2(d). Klaassen attempted to gain the benefit of this provision for the June 2013 Consent by arguing that he designated Hood and Simpkins as CEO. The right to designate directors, however, belongs to the current CEO. Consequently, if the current CEO directs or approves the removal of either Outside Director, then any party to the Stockholders' Agreement can exercise the right it otherwise has under the Charter and Bylaws remove the Outside Director without cause.

As already discussed, Klaassen no longer was CEO at the time he acted by written consent, so the first exception does not help him.

Klaassen fares better under second exception. It applies if "the Person(s) originally entitled to designate or approve such director pursuant to Section 9.2 is no longer so entitled to designate or approve such director." *Id.* § 9.4(a). This could occur for the Series A Directors or the Common Director if a majority of the Series A Preferred or the common stock, respectively, changed hands. It could occur for the Outside Directors if the CEO changed. At that point, any party to the Stockholders' Agreement could exercise the right it otherwise has under the Charter and Bylaws to remove the Outside Directors without cause, and the CEO could designate new Outside Directors.

For Simpkins, this was the situation at the time of the June 2013 Consent. Klaassen had been CEO and designated Simpkins to the Board as an Outside Director. Klaassen was "the Person(s) originally entitled to designate" the Outside Director seat filled by Simpkins. *Id.* By virtue of his termination, Klaassen was "no longer so entitled to designate" the Outside Directors. *Id.* He therefore could use his voting power to remove Simpkins without cause and did so through the June 2013 Consent.

If someone other than Hood had succeeded Klaassen as CEO, then Klaassen could have removed Hood on similar grounds. But the Stockholders' Agreement separately provides that the CEO shall be a director. Once Hood became CEO, the Stockholders' Agreement and Bylaws prevented Klaassen from removing him without cause. Klaassen therefore did not validly remove Hood.

3. Stritzinger And Velidi

Klaassen purported to fill the two Outside Director vacancies that he thought he created with Stritzinger and Velidi. Klaassen in fact created only one Outside Director vacancy, and Stritzinger and Velidi each received the same number of votes, *viz.,* the votes from all of Klaassen's shares. This decision need not consider how to break the tie because Klaassen failed to comply with the Stockholders' Agreement when filling vacancies, and the Bylaws require a party to the Stockholders' Agreement to do so.

Section 223 of the DGCL governs the filling of vacancies "[u]nless otherwise provided in the certificate of incorporation or bylaws." 8 *Del. C.* § 223(a). When a vacancy exists for a directorship elected by all of the stockholders voting together as a single class, then the vacancy "may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director." 8 *Del. C.* § 223(a)(1). When a vacancy exists for a special director elected by a particular class or series, then the vacancy "may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected." 8 *Del. C.* § 223(a)(2). As a matter of common law, stockholders having the power to vote in an election for the vacant directorship can fill the vacancy. *Campbell*, 134 A.2d at 857; *Moon v. Moon Motor Car Co.*, 151 A. 298, 302 (Del. Ch. 1930) (Wolcott, C.).

Allegro's Charter and Bylaws both address the filling of vacancies. Consistent with Section 223(a)(2), Section 3.3.1 specifies that "no such directorship may be filled by stockholders of the Corporation other than by the stockholders of the Corporation that are entitled to elect a person to fill such directorship, voting exclusively and as a separate

class." JX 11 § 3.3.1. Section 3.3.1 of the Charter states that if the Series A Preferred or the common stockholders do not fill their special directorships, then "any directorship not so filled shall remain vacant until such time as the holders of the Series A Preferred Stock or Common Stock, as the case may be, elect a person to fill such directorship." *Id.* The Charter does not address the filling of vacancies among the Remaining Directors. Under Section 223(a)(1), a Remaining Director vacancy can be filled "by a majority of the directors then in office, although less than a quorum, or by a sole remaining director." 8 *Del. C.* § 223(a)(1). As a matter of common law, stockholders holding a majority of Allegro's outstanding voting power can fill a Remaining Director vacancy. *Campbell*, 134 A.2d at 857; *Moon*, 151 A. at 302.

Article II, Section 11 of the Bylaws sets out a slightly different rule that nominally conflicts with Section 223, the Charter, and the common law. It states: "Unless otherwise provided in these Bylaws, vacancies on the Board of Directors . . . may only be filled as provided for in Section 9 of the Stockholders Agreement." JX 12 Art. II § 11. As with the removal bylaw, this provision as framed purports to disenfranchise stockholders who are not parties to the Stockholders' Agreement from exercising their common law right to participate in the filling of vacancies. To construe the bylaw in a manner that gives it a valid construction, I read it as stating that if stockholders who are parties to the Stockholders' Agreement seek to fill vacancies, they must comply with the terms of the Stockholders' Agreement.

By entering into the Stockholders' Agreement, Klaassen limited his ability to fill vacancies. He agreed that he could not unilaterally fill an Outside Director vacancy and

bound himself to support only nominees designated by the CEO and approved by the Series A Directors. Under the Bylaws, Klaassen only can fill a vacancy if he complies with the requirements of the Stockholders' Agreement. Klaassen was not CEO when he purported to fill vacancies with Stritzinger and Velidi and so failed to comply with the Stockholders' Agreement. Neither Stritzinger nor Velidi became a director, and the vacancy resulting from Simpkins's removal remains unfilled.

III. CONCLUSION

Hood is Allegro's CEO. The Board consists of Pehl and Forlenza as Series A Directors, Brown as the Common Director, and Klaassen and Hood as Remaining Directors. There are two vacancies: one Series A Director vacancy and one Remaining Director vacancy.