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Delaware Corporations Cannot Use Their Charter to Alter the Judicial Standard of Review

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In *Totta v. CCSB Financial*, the Court of Chancery invalidated a boards' invocation of an anti-takeover provision in the corporation's certificate of incorporation. It did so because the board invoked the provision to thwart an insurgent slate of director nominees without compelling justification. The anti-takeover provision at issue in *Totta* (Vote Limitation Provision) provided that no "person" that beneficially owns more than 10% of the company's stock would be permitted to vote the shares it held over and above that 10% threshold. "Person" was defined to include "groups acting in concert." The provision provided that the board could aggregate the shares of stockholders acting in concert in applying the limitation. It also granted the board with the authority and discretion as to whether and when to enforce the provision.

In advance of the company's 2021 election, one of the company's stockholders nominated three directors for election to the company's seven-member board. At the election, the stockholder's three nominees received a sufficient number of votes to be elected. However, seeking to prevent the election of the stockholder's nominees, the board invoked the Vote Limitation Provision to exclude a number of votes in favor of the stockholder's three nominees. The board invoked the Vote Limitation Provision by declaring that a particular group of stockholders acted in concert such that they could not vote more than 10% of shares owned by them collectively as a group. Given the invocation of the Vote Limitation Provision, the stockholder's three nominees were not elected.

The nominating stockholder sued, and the Court of Chancery invalidated the board's invocation of the Vote Limitation Provision. In doing so, the court found that while the invocation of the Vote Limitation Provision was legally permissible under the company's charter, it was inequitably applied here to thwart the will of a majority of the company's stockholders.

In Delaware, stockholder voting rights are sacrosanct. Thus, where the primary purpose of director action is to interfere with stockholder voting rights, the board must justify that action under enhanced scrutiny review by demonstrating a compelling justification for such interference. In this case, the company argued that because the charter contractually deems director decisions made in good faith and on the basis of information reasonably available "conclusive and binding," the board's invocation of the Vote Limitation Provision was entitled to a more deferential standard of review akin to business judgment rather than enhanced scrutiny. The court disagreed, holding that the conclusive and binding provision does not foreclose judicial review of the application of the charter provision in question under equitable principles. The court found that a corporate charter cannot bind the court to a particular standard of review, prevent it from applying equitable principles to evaluate the board's decision, or alter a director's fiduciary obligations unless expressly permitted to do so by statute. The company's interpretation of its charter would effectively nullify the directors' duty of loyalty owed to the company and its stockholders, something that, unlike other alternative entities like partnerships and limited liability companies, Delaware corporations are not permitted to do. For that reason, the court analyzed the board's invocation of the vote limitation principles under traditional equitable principles — here, enhanced scrutiny review. Because the court found that the board lacked a compelling justification for the invocation of the Vote Limitation Provision, it declared the invocation void. The court's ruling in *Totta* reminds corporations and their boards that they cannot use their charter to alter the judicial standard of review or waive the duty of loyalty, and that action taken to interfere with stockholder voting rights will continue to be reviewed under the more onerous enhanced scrutiny standard.

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