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Hilton Stockholder Vote Puts Spotlight on Legality of Binding Anti-Pill Bylaw Amendments

Stockholders of Hilton Hotels Corporation recently approved a labor union-initiated proposal to amend Hilton's bylaws to provide that Hilton "shall not maintain a shareholder rights plan [sometimes known as a 'poison pill'] . . . unless such plan is first approved by a majority shareholder vote." The passage of this proposal is lamentable as a matter of policy. It also puts a spotlight on the so-far-unanswered question of whether binding, shareholder-initiated bylaws of this nature are valid under Delaware law.

For very fundamental reasons, we believe that a binding bylaw of the type voted upon at the Hilton meeting is not valid under Delaware corporation law. Hilton, based on the opinion of Delaware counsel, reached the same conclusion, and has stated that its board will treat the proposal as a non-binding recommendation. We believe this approach is correct.

Under Delaware Code Section 141(a), directors have not only the power, but the obligation to attempt actively and in good faith to protect and advance the interests of the corporation and its stockholders. This fiduciary obligation requires that directors exercise their informed judgment in the circumstances as they appear from time to time. In our view, a majority of the voting shares may not in a bylaw limit the board's power to take such action as the board itself believes in good faith is necessary or appropriate to protect and advance the interests of the corporation and its stockholders. Should a majority of shares wish to pursue a policy of board disempowerment, as the union is attempting to do with its bylaw proposal at Hilton, the corporation law does not leave them without means to do so. Stockholders are free to elect new directors with different views of the best way to advance the purposes of the corporation. In addition, an amendment to the corporation's certificate of incorporation could validly constrain the powers of the board. That these alternative avenues for the enhancement of shareholder power over management are more difficult to effect is not, in our view, a flaw of the long-existing law, but rather a recognition that the complex governance of the large modern business corporation is a most serious matter that requires greater deliberation than is likely to occur in a single vote on a bylaw amendment.

Moreover, the use of shareholder-initiated binding bylaws to disable directors from fulfilling their obligation to protect the interests of stockholders is bad policy. The statutory duty to be active in protecting the interests of all stockholders is never more important than when a company is evaluating a potential sale of control or responding to activist stockholders seeking to influence or control the company for self-interested purposes. A board's ability to adopt and maintain a rights plan is among the most powerful and flexible tools available to enable directors to fulfill their obligations. Rights plans are also critical to the ability of a public company to conduct an orderly auction in the event the company seeks to sell itself. Repeated shareholder referenda are no substitute for board judgment, and are likely to prove impractical, ineffective and vulnerable to abusive tactics of small but vocal groups of shareholders whose interests may not be aligned with, or may be hidden from, stockholders generally. A bylaw that effectively demands director passivity at the very moments when active business judgment is most keenly needed contradicts the fundamental principles of our corporate law and does not serve the best interests of corporations or stockholders generally.

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