

CORPORATIONS QUESTION

Mega Inc. is a publicly traded corporation incorporated in a state whose corporate statute is modeled on the Model Business Corporation Act (MBCA). Mega's articles of incorporation do not address the election of directors or amendment of the bylaws by shareholders.

Well within the deadline for the submission of shareholder proposals for the upcoming annual shareholders' meeting, an investor, who was a large and long-standing shareholder of Mega, submitted a proposed amendment to Mega's bylaws. The proposal, which the investor asked to be included in the corporation's proxy materials and voted on at the upcoming shareholders' meeting, read as follows:

Section 20: The Corporation shall include in its proxy materials (including the proxy ballot) for a shareholders' meeting at which directors are to be elected the name of a person nominated for election to the Board of Directors by a shareholder or group of shareholders that beneficially have owned 3% or more of the Corporation's outstanding common stock for at least one year.

This Section shall supersede any inconsistent provision in these Bylaws and may not be amended or repealed by the Board of Directors without shareholder approval.

Mega's management decided to exclude the investor's proposal from the corporation's proxy materials and explained its reasons in a letter to the investor:

The investor's proposed bylaw provision would be inconsistent with relevant state law because the Board of Directors has the authority to manage the business and affairs of the Corporation. Generally, shareholders lack the authority to interfere with corporate management by seeking to create a method for the nomination and election of directors inconsistent with the method chosen by the Board of Directors.

Furthermore, at its most recent meeting, the Board of Directors unanimously approved an amendment to the Corporation's bylaws that provides for proxy access for director nominations by a shareholder or a group of shareholders holding at least 10% of the Corporation's voting shares for at least three years. This procedure takes precedence over any nomination methods that might be sought or approved by shareholders.

The investor is considering bringing a suit challenging management's refusal to include the investor's proposed bylaw provision and challenging the board's amendment of the bylaws at its recent meeting.

1. Is the investor's proposed bylaw provision inconsistent with state law? Explain.
2. If the investor's proposed bylaw provision were approved by the shareholders, would the bylaw amendment previously approved by the board take precedence over the investor's proposed bylaw provision? Explain.
3. Must the investor make a demand on Mega's board of directors before bringing suit? Explain.

Question Presented

Mega Inc. (publicly traded, MBCA) has articles silent on director elections and bylaw amendments. A long-standing shareholder timely proposed a bylaw giving proxy access to shareholders holding 3% for one year.

← *may shareholders amend bylaws on director-nomination procedures?*

The proposal also stated that it may not be amended or repealed by the board without shareholder approval.

← *a shareholder 'no board repeal' lock*

Management excluded the proposal and noted the board had just adopted its own stricter proxy-access bylaw (10% for three years) that 'takes precedence'.

← *board bylaw vs. a later shareholder bylaw: which controls?*

The investor is considering suing to challenge both the exclusion of his proposal and the board's bylaw amendment.

← *direct (own voting rights) or derivative (entrenchment)?*

1. *Is the investor's proposed bylaw inconsistent with state law?*

← → *shareholder power to amend bylaws*

2. *Would the board's earlier bylaw take precedence over the shareholder-approved one?*

← → *board vs. shareholder bylaw power*

3. *Must the investor make a demand on the board before suing?*

← → *direct vs. derivative*

Question 1: Shareholder Power to Amend the Bylaws

Issue. Whether the investor's proposed proxy-access bylaw is inconsistent with state law.

Can shareholders adopt this bylaw at all?

Rule. Under the MBCA, shareholders have the power to amend the corporation's bylaws, and the bylaws may contain any provision not inconsistent with law or the articles. Procedures for nominating and electing directors, including proxy access, are a proper subject for the bylaws, and a binding shareholder bylaw on such a procedural matter does not improperly invade the board's authority

Shareholders may amend bylaws; director-nomination procedures (proxy access) are a proper subject; not limited to precatory resolutions here.

to manage the business.

Analysis. Here, the proposal sets a **procedure for shareholder nomination of directors** (proxy access for 3%/1-year holders), a classic proper subject for the bylaws that the MBCA expressly lets shareholders adopt. Management's objection that this usurps the board's management power fails, because shareholders have specific authority to amend the bylaws and are not confined to mere recommendations when they do.

Conclusion. Therefore, the proposed bylaw is not inconsistent with state law, and the shareholders may adopt it.

Nomination procedure = proper bylaw subject; specific power to amend defeats the 'board manages' objection.

Not inconsistent; shareholders may adopt it.

Question 2: Board Bylaw vs. Shareholder Bylaw

Issue. Whether the board's earlier proxy-access bylaw would take precedence over the investor's bylaw if the shareholders approve it.

Rule. The board and shareholders share the power to amend bylaws, but a shareholder-approved bylaw may amend or repeal a board-adopted bylaw, and shareholders may expressly bar the board from later amending or repealing a shareholder-approved bylaw; the board cannot limit the shareholders' power. (Under the proxy-access rules the board retains only a narrow power to adjust procedures to keep the process orderly, not to frustrate the shareholder bylaw.)

Analysis. Here, if the shareholders approve the investor's bylaw, it **supersedes the board's stricter 10%/3-year bylaw**, and its **no-board-repeal clause** bars the board from undoing it. The board's earlier amendment therefore does not take precedence over the later shareholder-approved bylaw.

Conclusion. Therefore, the board's bylaw would not take precedence; the shareholder-approved bylaw controls.

Whose bylaw wins?

Shareholder bylaw can repeal a board bylaw and can lock out board repeal; the board can't limit shareholders.

Shareholder bylaw supersedes the board's and the no-repeal clause locks the board out.

Shareholder bylaw controls.

Question 3: Demand, Direct vs. Derivative

Issue. Whether the investor must make a pre-suit demand on the board before suing.

Rule. A shareholder must make a pre-suit demand on the board before bringing a derivative suit (a claim on the corporation's behalf, typically for breach of fiduciary duty). No demand is required for a direct suit that vindicates the shareholder's own

Is demand required?

Derivative (corporation's claim) → demand; direct (own rights) → no demand.

rights, such as voting rights.

Analysis. Here, it depends on the framing. If the investor sues to vindicate his **own shareholder voting rights** (the wrongful exclusion of his proposal and interference with his right to amend the bylaws), the claim is direct and no demand is required. If he instead claims the **directors breached their fiduciary duties by entrenching themselves**, that claim belongs to the corporation, is derivative, and requires a demand.

Conclusion. Therefore, the investor need not make a demand for a direct voting-rights claim, but must make a demand for any derivative entrenchment claim.

Voting-rights theory = direct (no demand); entrenchment/fiduciary theory = derivative (demand).

No demand if direct; demand if derivative.

Step-by-Step: Bylaw Amendments & Demand

Confirm shareholders may act, resolve whose bylaw controls, then classify the suit to see whether demand is required.

1. Is the bylaw a proper subject for shareholder action?

→ Shareholders may amend bylaws; director-nomination procedures (proxy access) are proper and not inconsistent with law → **valid**. **Q1: proposal is valid**



2. Board bylaw vs. a later shareholder bylaw?

→ Shareholders may repeal a board bylaw and may bar board repeal; the board can't limit shareholders → the **shareholder bylaw controls**. **Q2: shareholder bylaw supersedes**



3. Demand before suit? Classify the claim.

→ Direct (own voting rights): **no demand**.

→ Derivative (fiduciary-duty entrenchment, on the corporation's behalf): **demand required**. **Q3: depends on framing**