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Nutrisystem Rule For Director Ousters Struck Down In Del.

By **Jeff Montgomery**

Law360, Wilmington (January 24, 2017, 7:28 PM EST) -- Nutrisystem Inc.'s bylaws carry an overweight and unlawful supermajority shareholder vote provision for removing directors, a Delaware vice chancellor ruled on Tuesday.

The summary judgment decision by Vice Chancellor Sam Glasscock III sided with a shareholder's claim that the company improperly required a two-thirds minimum vote to toss directors, violating a simple majority requirement in Delaware's General Corporation Law.

Stockholder Harold Frechter sued the company in early 2016, asking the Delaware Chancery Court to strike down the provision and accusing directors of breaching their duty and attempting to entrench themselves through the vote requirement.

"Under the plain language of the statute, I find that the removal provision is inconsistent" and based on an "unnatural reading" of Delaware's corporation law, Vice Chancellor Glasscock said in an 11-page opinion and order. He described as "not easily comprehensible" Nutrisystem's arguments that a permissive interpretation left room for tougher requirements, even though the law states only that directors "may be removed by a majority vote of corporate shares."

In rejecting Nutrisystem's position, Vice Chancellor Glasscock said the company's interpretation could justify bylaw choices that allow votes of less than 50 percent for director removals.

"The defendants appear to rest this argument — which is, frankly, not easily comprehensible to me — on the contention" that the relevant Delaware corporation rule "is merely permissive," the opinion said. The company's argument that a simple majority "may" remove directors, but only if company bylaws agree, the opinion added, "renders the 'majority' provision essentially meaningless, and leaves the statutory provision an effective nullity."

The vice chancellor's decision also approved withdrawal of the fiduciary breach claim by Frechter, whose attorney noted during court arguments last year that the claim would be pulled if the court rejected dismissal and struck down the removal restriction.

Nutrisystem's board removal provisions attracted shareholder attention during the company's response to a related Chancery Court decision in a case known as *In re Vaalco Energy Inc. Stockholder Litigation*. That December 2015 decision barred requirements that stockholders provide a reason for removing directors.

"Any 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.' That is the rule," Vice Chancellor Glasscock wrote, quoting Vice Chancellor J. Travis Laster's *Vaalco* decision.

Nutrisystem's board dropped its own "for cause" requirement less than a month after the *Vaalco* ruling, in January 2016, but retained the two-thirds vote requirement.

Nutrisystem's attorneys had argued that the more restrictive vote requirement was "not prohibited," and said that attorneys for Frechter were unable to cite a specific case upholding the simple majority restriction.

In addition, they rejected the alleged entrenchment motivation, pointing out that the company had only retained a provision that had been in place for many years when it dropped the for-cause removal requirement. During annual meetings, they added, Nutrisystem's entire board faces a shareholder vote that allows removal by only a plurality, despite the more general two-thirds provision.

In the opinion, the vice chancellor pointed out that in order to win a summary judgment motion, attorneys for Frechter had to overcome a presumption that the bylaws are valid and prove that they fail "in any conceivable circumstance."

During arguments late last year, the vice chancellor made it clear he was almost there already, and "extremely unlikely" to uphold the supermajority requirement. He also said, however, that he was willing to consider the supermajority rule's presence in the company's bylaws as "simple carelessness," rather than a fiduciary duty breach.

The plaintiff is represented by Jessica Zeldin of Rosenthal Monhait & Goddess PA and Carl L. Stine of Wolf Popper LLP.

Nutrisystem is represented by M. Duncan Grant, Christopher B. Chuff and Jay A. Dubow of Pepper Hamilton LLP.

The case is Frechter v. Zier et al, case number 12038, in the Delaware Court of Chancery.

--Editing by Catherine Sum.

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