

## Pay Attention to Bylaws When Taking Corporate Actions

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All too often, family businesses are run in an “informal” fashion, with insufficient attention being paid to corporate formalities, including requirements set forth in a corporation’s bylaws. The Delaware Chancery Court recently ruled in *Rainbow Mountain, Inc. vs. Begeman* (March 23, 2017), that even in a family-owned business where all of the parties to a dispute are family members, the bylaws will control corporate actions.

In *Rainbow Mountain*, the defendant Terry Begeman was a member of the family that had founded the corporation. After a falling out among the family members, the group that held a controlling interest sought to remove Terry from the board of directors of the corporation, and in 2008 voted him off of the board of directors. Terry refused to accept this removal, and in 2014 the corporation filed an action for declaratory judgment seeking to confirm that Terry had been removed from the board.

The Chancery Court ruled that a number of actions taken by the controlling shareholders were ineffective because of a failure to comply with the corporation’s bylaws.

The Chancery Court firmly rejected the corporation’s position. Citing long-standing precedent that “[c]orporate charters and bylaws are contracts among a corporation’s shareholders,” the Chancery Court ruled that a number of actions taken by the controlling shareholders (including the removal of Terry from the board) were ineffective because of a failure to comply with the corporation’s bylaws. In Terry’s case specifically, the bylaws required a vote of two-thirds of the other directors to remove a sitting director, and because of the failure of some of the other corporate actions the board did not reach the supermajority threshold required.

The *Rainbow Mountain* case serves as another reminder of the necessity of complying with corporate formalities. Even though the judge in a related case (filed in a different jurisdiction) held that the corporation’s bylaws were not binding and were simply a matter of “custom, acquiescence and course of conduct,” the Chancery Court held that for actions specifically contemplated by the bylaws, the bylaws would control. It is always a good practice to be familiar with the bylaws (including any amendments) and other charter documents before undertaking an action that might be addressed by them.

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