

KIRKLAND M&A UPDATE

June 30, 2009

Delaware Adopts Important Amendments to its General Corporation Law

Recent amendments to the General Corporation Law of the State of Delaware, effective August 1, address important and evolving areas of corporate law and governance.

In April 2009 the Delaware legislature passed and the Delaware Governor signed into law various amendments to the General Corporation Law of the State of Delaware (the "DGCL"). The amendments address issues relating to:

- shareholder access to proxy materials;
- reimbursement of proxy solicitation expenses;
- indemnification rights and advancement of expenses;
- fixing record dates for shareholder meetings; and
- removal of directors.

The amendments address important and evolving areas of corporate law and governance. The amendments will become effective on August 1, 2009.

Shareholder Access to Proxy Solicitation Materials

The amendments add a new §112 to the DGCL, which provides that a Delaware corporation may (but need not) provide in its bylaws that if the corporation solicits proxies for the election of directors, it can be required to include in its proxy statement and on its proxy card nominees of stockholders of the corporation. The corporation's obligation to include stockholder nominees in its proxy materials can be made subject to specified procedures and conditions. The new statute sets forth a non-exclusive list of some such procedures and conditions:

- minimum number of shares owned beneficially or of record by the nominating stockholder;
- minimum ownership period of the nominating stockholder;
- information regarding the nominating stockholder and its nominees, including stock ownership levels;
- number or proportion of nominees by the nominating stockholder and whether the nominating stockholder has previously sought inclusion of its nominees in the corporation's proxy materials;
- a right to exclude nominees if the nominating stockholder, a

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nominee or any of their affiliates or associates has acquired or publicly proposed to acquire more than a specified percentage of the corporation's stock within a specified period prior to the election of directors;

- an obligation on the part of the nominating stockholder to indemnify the corporation for any losses incurred by the corporation resulting from false or misleading information submitted by the nominating stockholder for inclusion in the corporation's proxy materials; and
- any other lawful condition.

Shareholder access to a corporation's proxy materials has been a hot topic for a number of years. In 2003 and 2007, the SEC proposed amendments to the proxy rules promulgated under the Securities Exchange Act of 1934 that would have required shareholder access under certain circumstances, but both times the rules were not ultimately adopted. On June 10, 2009, the SEC again issued proposed amendments to the federal proxy rules that would require a corporation subject to the rules to include in its proxy materials director nominees of shareholders under certain circumstances.¹ The amendments to the DGCL essentially anticipated the SEC's action in proposing this new set of amendments to the federal proxy rules.

Reimbursement of Proxy Solicitation Expenses

The amendments also add a new §113 to the DGCL, which provides that a Delaware corporation may (but need not) provide in its bylaws that the corporation is required to reimburse stockholders for expenses incurred in connection with soliciting proxies for the election of directors. Like proxy access discussed above, this reimbursement obligation can be made subject to specified procedures and conditions. The new statute sets forth a non-exclusive list of some such procedures and conditions:

- number and proportion of nominees by the stockholder seeking reimbursement or whether the particular stockholder previously sought reimbursement;
- limitation on the amount of reimbursement based on the proportion of votes cast in favor of the stockholder's nominees or on the amount spent by the corporation in soliciting proxies in connec-

tion with the election;

- limitations concerning the election of directors by cumulative voting; and
- any other lawful condition.

This new statute was a response to the Delaware Supreme Court's decision in *CA, Inc. v. AFSCME Employees Pension Plan*² in which the Court held that a stockholder proposal providing for a bylaw amendment requiring reimbursement of expenses incurred by a stockholder in soliciting proxies is valid if it is properly drafted. On the facts of that case, however, the Court found that the proposed bylaw was invalid because it did not grant the board of directors the right or ability to deny reimbursement if it was compelled to do so by the directors' fiduciary duties. The *CA* decision probably requires a board of directors to retain this discretion even if it adopts such a bylaw.

Prohibition on Retroactive Limitation on Indemnification and Advancement of Expenses

DGCL §145 addresses the rights and obligations of Delaware corporations to indemnify and provide expense reimbursement to its directors, officers, employees and agents. Section 145 provides generally that a corporation has the right (but not the obligation) to indemnify directors' officers, employees and agents for losses they incur in serving in such capacities on behalf of the corporation as long as they acted in good faith and in a manner believed to be in the best interests of the corporation and, with respect to a criminal proceeding, if they had no reasonable cause to believe the act in question was unlawful.

The amendments add a new sentence to §145 to provide that the right to indemnification or the advancement of expenses under a provision of a corporation's articles of incorporation and/or bylaws cannot be eliminated or impaired by any amendment to the provision after the occurrence of the act or omission that gives rise to a claim for indemnification or advancement of expenses unless the provision in effect at the time explicitly authorizes such elimination or impairment after the fact.

The amendment is a direct response to the Delaware Chancery Court's decision in *Schoon v. Troy Corp.*,³ in which the Court held that a corporation can amend a provision of its certificate of incorporation or bylaws

to eliminate or impair a right of indemnification after the occurrence of an act or omission that ultimately gives rise to a claim for indemnification as long as the amendment is made before the commencement of the proceeding in which the claim is asserted. Many directors and officers, as well as many lawyers, found the *Schoon* decision surprising and alarming and many corporations quickly amended their bylaws to prohibit retroactive elimination or impairment of rights regarding indemnification and advancement of expenses.

Separate Record Dates for Notice of Meeting and Right to Vote

Section 213 of the DGCL currently provides that a Delaware corporation can fix a record date to determine which stockholders are entitled to receive notice of stockholder meetings and are entitled to vote at the meeting. Under Section 213, that date must be the same date. Under the statute the record date must be no more than 60 days and no less than 10 days before the meeting date.

The amendments provide that a corporation can set separate record dates to determine which stockholders receive notice of a stockholders meeting and which stockholders are entitled to vote at the meeting. The record date to receive notice of the meeting remains unchanged: no more than 60 days and no less than 10 days before the meeting date. However, the record date to determine which stockholders are entitled to vote at the meeting can be any date on or before the meeting date.

The amendments are intended to partially address the “empty voting” problem where stockholders own and vote stock as of the record date and thereafter sell it before the meeting date, thus divorcing the voting from the economic consequences of the vote. Empty voting has played a role and become an issue in a number of change-of-control transactions in recent years, particularly in situations where hedge funds or other activist investors have (i) acquired large blocks of stock in a merger party, (ii) voted the stock on or before the record either in favor of or against the merger, (iii) disposed of the stock thereafter but before the meeting date and (iv) sought to profit from

the outcome of the meeting vote through holdings of derivative securities such as puts, calls or options.

It should be noted that New York Stock Exchange Rule 401.03 expressly states that there is “no rule of the Exchange bearing on the interval between record and meeting dates.” However, the rule provides that the Exchange “recommends” a minimum of 30 days between the record date and the meeting date “so as to give ample time to solicit proxies.” It is unclear whether this recommendation applies to the record date for determining who is entitled to vote at the meeting as well as who is entitled to receive notice of the meeting.

Court Authority to Remove Directors

Section 141(k) of the DGCL currently provides for the removal of directors, with or without cause, upon a majority vote of stockholders. Under the statute, if a corporation has a classified board, unless the certificate of incorporation provides otherwise, directors can be removed only for cause. If directors are elected by a specified class or series of stock, only a vote of the relevant class is necessary for removal. Special rules apply to corporations with cumulative voting.

The amendments add a new sub-section (c) to Section 225 of the DGCL, which provides that if a director has been convicted of a felony in connection with his duties as a director, or is found to have breached his duty of loyalty to the corporation, then upon application of the corporation (or a shareholder acting derivatively on behalf of the corporation) to the Chancery Court, the court can remove the director upon a finding that:

- the director did not act in good faith in performing the acts in question, and
- removal is necessary to avoid irreparable harm to the corporation.

The addition of this sub-section (c) to Section 225 is the only Delaware statutory means by which a board of directors can remove one of its members. The standard for removal, however, creates a high hurdle for a board seeking to take this action.

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- 1 SEC Rel. Nos. 33-9046; 34-60089. The proposed amendments to the federal proxy rules are discussed in a previous *Kirkland M&A Update* from May 29, 2009, titled "[Looking Ahead to the Future of Proxy Access.](#)"
 - 2 CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008).
 - 3 Schoon v. Troy Corp., 948 A.2d 1157 (Del. Ch. 2008).
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