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Officer Exculpation Under Delaware Law

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Delaware Law Changed to Permit Exculpation of Officers

The charter of virtually every publicly traded Delaware corporation provides for the "exculpation" of directors from personal monetary liability for breaches of the duty of care

- Exculpation refers to the elimination, to the fullest extent permitted by Delaware law, of a director's personal liability for any monetary damages for breach of fiduciary duties as a director of the Company
  - Unlike indemnification, exculpation bars claims for damages against directors, and as a matter of law, the case can be dismissed before any litigation progresses
- Delaware law does not permit exculpation provisions to eliminate liability for breaches of the duty of loyalty, acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, unlawful dividends, or for any transaction from which the director derived an improper personal benefit
- Thus, in practice, exculpatory provisions eliminate monetary liability for directors for breach of the duty of care

Effective as of August 1, 2022, Delaware law permits a corporation to adopt an "exculpation" provision to cover corporate officers

- Covered officers eligible for such exculpation include (1) the corporation's president, CEO, COO, CFO, CLO (General Counsel), controller, treasurer or chief accounting officer, (2) an individual identified in public filings as one of the most highly compensated officers of the corporation; and (3) an individual who, by written agreement with the corporation, has consented to be identified as an officer under Delaware's long-arm statute
- Like exculpation provisions for directors, the new officer provision does not permit exculpation for breaches of the duty of loyalty, acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, or for any transaction from which the director derived an improper personal benefit
  - In addition, the new officer provision does not permit exculpation in the context of claims brought by or in the right of the corporation (i.e., derivative claims)
- Thus, in practice, exculpatory provisions can eliminate monetary liability for officers for breach of the duty of care, where such claims are direct in nature

Why is Exculpation Needed for Officers?

Fiduciary Duty Litigation Against Officers Has Arisen in the M&A Context

- Under Delaware law, officers owe the same fiduciary duties as directors, but fiduciary duty claims against officers were historically rare
- But in the context of litigation arising out of the sale of a company, plaintiffs have begun naming officers (in addition to directors) as defendants, alleging that officers breached their duty of care by causing the company to issue materially misleading disclosures in merger proxy statements or tender offer documents
  - These claims are not brought against directors because directors are exculpated for care claims
  - Because officers historically have not been exculpated for care claims, these new disclosure-based care claims provided a route for plaintiffs to survive a motion to dismiss even where there were otherwise no challenges to the company's sale process
  - Litigating these care claims against officers is not only costly, but it also enhances settlement leverage for plaintiffs' lawyers

How Does Officer Exculpation Address These Issues?

- The net effect of the new officer provision is to prohibit direct claims against officers for breaching the duty of care; officers still cannot be exculpated for derivative care claims
- While the provision was adopted to address issues arising in the M&A context, exculpation for officers applies to care claims arising in any context where claims would be direct (but not derivative)
- An officer exculpation provision benefits companies as it reduces plaintiffs' settlement leverage for such direct claims while at the same time retaining the board's ability to pursue claims against officers through derivative litigation where appropriate

Adopting Exculpation for Officers

Process to adopt officer exculpation charter amendment:

- Adopting officer exculpation requires an amendment to a corporation's charter (i.e., cannot be done by amending the Bylaws)
- Submitting a charter amendment to a shareholder vote would require the corporation to file a preliminary proxy statement

As the Delaware statute was only recently implemented, it is unclear how institutional investors and proxy advisors will react to charter amendments to provide for officer exculpation

- ISS adopted a policy stating it would evaluate officer exculpation provisions on a case-by-case basis after it had proposed a policy of generally recommending in favor; many expect ISS to still generally recommend in favor of such provisions for Delaware corporations
- Glass Lewis adopted a policy stating it would generally recommend against an officer exculpation provision unless there is a compelling rationale for it and the provision is reasonable
- As of mid-November, ISS and Glass Lewis had supported an officer exculpation charter amendment in 7 of 8 situations, and 6 of 8 were approved by stockholders (see next page for more details)
  - However, since mid-December, Glass Lewis has recommended voting against each of the 3 officer exculpation charter amendments put to a vote while ISS has continued to recommend voting for such proposals
- We are seeing a number of companies that are not deterred by the uncertainty stemming from the recently adopted ISS and Glass Lewis policies, while others are electing to take a "wait and see" approach to better understand how proposals to adopt officer exculpation are treated by institutional shareholders and proxy advisors as the 2022-2023 proxy season unfolds

ISS and Glass Lewis Voting Policies and Early Results

Issue	ISS 2023 Policies	Glass Lewis 2023 Policies
Adding Officer Exculpation Provisions to DE Company Charters	► Will vote case-by-case on shareholder proposals ► Will consider the stated rationale for the proposed change and, among other factors, the extent to which the proposal would eliminate directors' and officers' liability for monetary damages for duty of care violations, among other factors ► Final policy is less clear than ISS' proposed draft policy, which stated that ISS would generally recommend in favor of exculpation proposals as a default rule	► Will evaluate proposals on a case-by-case basis ► Will ***generally recommend against*** proposals eliminating monetary liability for breaches of duty of care for certain corporate officers unless compelling rationale for adoption is provided by the board and provisions are reasonable

OFFICER EXCULPATION CHARTER AMENDMENTS IN PRACTICE – UPDATE ON ISS / GL AND SHAREHOLDER RESPONSES

Of the 11 officer exculpation charter amendment proposals that have gone to a vote (as of January 1), 8 were approved

- The 3 that failed were due to insufficient voting participation to constitute the majority required for approval, with 2 of the 3 requiring a two-thirds supermajority vote for approval (though the majority of votes actually cast were in favor of the amendment in all 3 cases)
- Through December 5, ISS and Glass Lewis recommended voting for each such proposal put to a vote (with one exception)
- Since December 5, Glass Lewis has recommended voting against all 3 such proposals while ISS has continued to recommend voting in favor

Company	Vote Date	Outcome	% Outstanding Shares*
GUIDEWIRE	12/20/22	✓	70.5%
MATRIX SERVICE	12/5/22	✓	60.6%
TSR CONSULTING SERVICES	11/30/22	✘	54.6**
AKOUSTIS	11/10/22	✘	37.2%
axos FINANCIAL	11/10/22	✓	77.2%

Company	Vote Date	Outcome	% Outstanding Shares*
vmware	11/4/22	✓	82.6%
FOX	11/3/22	✓	87.4%
AVID BIOSERVICES	10/18/22	✓	74.2%
TEAM	11/8/22	✘	51.1%**
QCi	9/21/22	✓	52.3%
SWK HOLDINGS	8/10/22	✓	85.7%

* Percentage of outstanding shares entitled to vote (rather than a percentage of votes actually cast)
** Proposal required affirmative vote of at least two-thirds of shares outstanding
Source: 8-K filings; ISS Governance Analytics tool and voting recommendations for proposals