

Amendments to Delaware General Corporation Law May Aid Activist Stockholders

On April 10, 2009, Delaware Governor Jack Markell signed into law House Bill 19, which contains important amendments to the Delaware General Corporation Law (DGCL) expected to aid activist stockholders. Among other provisions, the amendments expressly permit (but do not require) Delaware corporations to adopt bylaw provisions granting stockholders access to a company's proxy statement for the nomination of directors and also permit (but do not require) Delaware corporations to adopt bylaw provisions permitting the reimbursement of expenses incurred by a stockholder in a proxy contest.

The amendments also prohibit retrospective amendment of indemnification provisions contained in a corporation's governing documents, allow corporations to provide different record dates for stockholders entitled to notice of a meeting and stockholders entitled to vote at a meeting, and permit the judicial removal of directors convicted of a felony in certain circumstances.

The new provisions will take effect on August 1, 2009.

Access to Proxy Materials

New Section 112 of the DGCL clarifies that a corporation's bylaws may (but are not required to) provide that if the corporation solicits proxies with respect to the election of directors, the corporation may be required to include in its proxy materials (including any form of proxy) one or more nominees submitted by stockholders in addition to individuals nominated by the board of directors.

The new provision also identifies a non-exclusive list of procedures and conditions that the bylaws may impose on such a right of access to the corporation's proxy materials. These procedures and conditions include:

- A proscribed minimum level and/or duration of stock ownership by the nominating stockholder;
- A provision requiring the nominating stockholder to submit specified information concerning the stockholder and the stockholder's nominee(s);
- A condition of eligibility upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require such inclusion;
- A preclusion where the nomination is related to an acquisition of a significant percentage of the corporation's stock within a specified period before the election of directors;
- A provision requiring that the nominating stockholder indemnify the corporation in respect of any loss arising as a result of any false or misleading statement or information submitted by the nominating stockholder in connection with a nomination; or
- Any other lawful condition.

Currently, a Securities and Exchange Commission (SEC) rule poses a barrier to stockholder proxy access. In January 2008, the SEC amended its stockholder proxy access Rule 14a-8 to allow public companies to exclude shareholder proposals related to the election of directors (including proposals to amend bylaws related to the election of directors) from shareholder voting materials. However, SEC Chairman Mary Schapiro has recently indicated that the SEC will propose several proxy access alternatives in May to allow stockholders to nominate director candidates to appear on management proxy statements. The details of the alternatives are still under discussion, but Chairman Schapiro indicated that the proposals likely will include a “direct access” rule and a mechanism to allow shareholders to file access bylaw proposals at companies. The amendment to the DGCL will be of limited benefit to activist stockholders unless and until the SEC changes its interpretation that stockholders may not submit proposals under Rule 14a-8 to implement such a bylaw proposal.

Reimbursement of Solicitation Expenses

New Section 113 permits (but again, does not require) the bylaws of a corporation to provide for reimbursement of reasonable proxy solicitation expenses incurred by a stockholder in the solicitation of proxies in connection with an election of directors.

The bylaws may impose conditions upon the reimbursement of expenses, including:

- The number or proportion of persons nominated by the stockholder seeking reimbursement or whether such stockholder previously sought reimbursement for similar expenses;
- Limitations on the amount of reimbursement based upon the proportion of votes cast in favor of the stockholder’s nominees, or based upon the amount spent by the corporation in soliciting proxies in connection with the election;
- Limitations concerning elections of directors by cumulative voting; or
- Any other lawful condition.

Section 113 codifies the decision reached last year by the Delaware Supreme Court in *CA, Inc. v. AFSCME Employees Pension Plan*, in which the Court held that a stockholder bylaw amendment proposal that provides for reimbursement of stockholder proxy expenses by a corporation may be a valid proposal, because it is procedural rather than substantive in nature. It is important to note that in that case, the supreme court struck down the proposal in question because, if adopted, the directors would be committed to reimburse expenses in all circumstances and thus directors would be prevented from fully discharging their fiduciary duties. It is unclear whether the legislature intended to override this aspect of the supreme court’s holding, but the amendment is silent on the issue of fiduciary duties. Accordingly, courts may read such a fiduciary duty into a proposed bylaw provision if there is no carve-out for the director’s exercise of fiduciary duties.

Prohibition of Retroactive Elimination of Indemnification or Advancement

Section 145 of the DGCL governs the indemnification and advancement of expenses by a corporation for officers, directors, employees and agents of the corporation. Under the amendment to Section 145(f), any right to indemnification or to advancement of expenses arising under a provision of the corporation’s certificate of incorporation or bylaws may not be eliminated or impaired by an amendment to such provision that takes place after the occurrence of the act or omission giving rise to the indemnification or advancement claim, unless the provision in effect at the time of such act or omission explicitly authorizes such elimination or impairment after such action or omission has occurred.

This amendment overrides the holding set forth in *Schoon v. Troy Corp.*, which provided that an elimination or impairment may be made following the occurrence of the act or omission which is the subject of the proceeding for which indemnification or advancement is sought as long as it is made before the commencement of the underlying proceeding.

Other Matters

Dual Record Dates

The recently signed bill also contains amendments which effectively permit the board of directors of a Delaware corporation to set different record dates for determining which stockholders are entitled to notice of any meeting and which stockholders are entitled to vote at such meeting. The record date for the notice to stockholders remains unchanged under the DGCL (not more than 60 days and not less than 10 days before the date of the meeting). The record date for determining which stockholders are entitled to vote at the meeting may be any date on or before the date of the meeting. These amendments allow corporations to deal with the so-called “empty-voting problem,” resulting when stockholders have a voting right for a particular meeting but no longer hold an economic interest in the corporation.

Court Authority to Remove Directors

Finally, new Section 225(c) grants the Delaware Court of Chancery the power to remove directors convicted of a felony in connection with their duties as director under specified circumstances. The removal action must be brought directly by or derivatively in the right of the corporation, and must be preceded by the adjudication of the felony conviction. Judicial removal of the director is then only permitted where the Court determines that the director did not act in good faith and the judicial removal is necessary to avoid irreparable harm to the corporation.

If you would like to learn more about the amendments to the DGCL, please contact your usual legal advisor at Ropes & Gray.

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