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Change to Delaware General Corporation Law May Enliven 2010 Proxy Season © ¶10.1

By *Scott Towers and Catherine L. Beck, Ballard Spahr Andrews & Ingersoll, LLP, Philadelphia, PA*

Delaware Governor Jack Markell signed into law on April 10, 2009, a bill containing significant amendments to the Delaware General Corporation Law (DGCL). The amendments take effect August 1, 2009, and two of them are likely to be catalysts for proposals by activist stockholders in the 2010 proxy season. The amendments may result in stockholders having greater access to companies'

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proxy statements and rights to expense reimbursement for proxy solicitations with respect to director elections.

New Section 112 of the DGCL permits, but does not require, a Delaware corporation to adopt bylaw provisions that require director nominations by stockholders to be included in the corporation's proxy statement. New Section 113 permits, but does not require, a Delaware corporation to adopt bylaw provisions that could require the corporation to reimburse proxy-solicitation expenses incurred by a stockholder in connection with an election of directors.

Stockholder activism regarding such bylaw amendments likely will not be limited to corporations domiciled in Delaware because the laws of many other states (including Pennsylvania) are silent on the topic and, arguably, permit corporations to adopt such amendments.

Another of the recent amendments to the DGCL significantly limits the ability of a Delaware corporation to eliminate rights to indemnification and advancement of

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expenses. An amendment to Section 145(f) of the DGCL provides that rights to indemnification and advancement of expenses may not be eliminated after the occurrence of the act or omission giving rise to a claim in respect of which indemnification or advancement is sought, unless the relevant provision expressly permits such elimination.

Stockholder Access to Proxy Materials

New Section 112 states that a corporation's bylaws may grant access to its proxy materials to stockholders in connection with the election of directors. The bylaws may provide that if a corporation solicits proxies in such elections, it must include in its proxy materials, in addition to board nominees, nominees submitted by a stockholder.

Section 112 identifies a nonexclusive list of conditions and procedures that the bylaws may impose on access to the corporation's proxy materials, including:

- a provision requiring a minimum amount of ownership, or duration of ownership, of shares by the nominating stockholder;
- a provision requiring the nominating stockholder to submit specified information concerning the stockholder and the stockholder's nominees;
- a provision conditioning eligibility upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require such inclusion;
- a provision precluding nominations by any person who has acquired or proposed to acquire a specified percentage of the corporation's stock within a specified period before the election of directors;
- a provision requiring that the nominating stockholder indemnify the corpora-

tion 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.

Reimbursement of Stockholders' Proxy Solicitation Expenses

Section 113 expressly permits the bylaws of a corporation to provide for reimbursement of reasonable proxy solicitation expenses incurred by a stockholder in soliciting proxies in connection with an election of directors.

Similar to Section 112, Section 113 sets forth a nonexclusive list of procedures and conditions that may be imposed upon the right to the reimbursement of expenses, including:

- conditioning reimbursement upon 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.

New Section 113 was adopted in response to the 2008 Delaware Supreme Court decision in *CA, Inc. v. AFSCME Employees Pension Plan*, which held that a stockholder's bylaw amendment proposal to require reimbursement of stockholder proxy expenses by a corporation may be a valid proposal, so long as the bylaw

“establishes or regulates a process for substantive director decision-making” and reserves for directors the power to exercise their fiduciary duty to decide whether it would be appropriate to reimburse expenses in a specific situation. Although Section 113 does not contain such a “fiduciary out” requirement, a bylaw provision requiring reimbursement of proxy expenses should contain such an exception in light of the *AFSCME* decision. (If such an exception is not included, a court may nevertheless read one into such a bylaw provision in light of the *AFSCME* decision.)

Indemnification and Advancement Rights

An amendment to Section 145(f) of the DGCL prohibits the amendment of a provision of a company’s certificate of incorporation or bylaws that would eliminate or impair rights to indemnification or to advancement of expenses after the occurrence of the act or omission giving rise to the indemnification or advancement claim, unless the relevant provision explicitly authorizes such elimination or impairment after such an act or omission has occurred.

This amendment responds to and rejects the Delaware Chancery Court’s holding in *Schoon v. Troy Corp.*, which denied advancement of a former director’s litigation expenses where the company amended its bylaws to eliminate its obligation to advance expenses after the director left office, even though the action giving rise to the advancement claim occurred at a time when the bylaws would have required advancement.

In response to the *Schoon* holding, many companies amended their bylaws, or entered into separate indemnification agreements, to protect their directors and former directors from such retroactive

bylaw amendments regarding the advancement of expenses. For directors serving Delaware corporations that did not so amend their bylaws, the amendment to Section 145(f) provides assurance that existing indemnification and advancement protections cannot be retroactively amended. Corporations domiciled in states other than Delaware that wish to provide their directors with the greatest permissible degree of protection should consider amending their bylaws or charters, or entering into separate indemnification agreements, to protect directors from such retroactive amendments, unless the bylaws or charters, existing indemnification agreements, or applicable state law, already do so.

Effect of SEC Rules and Proposals on DGCL Amendments

The recent DGCL amendments likely will lead activist stockholders to make proposals requesting bylaw amendments relating to proxy access for director nominees and reimbursement of proxy solicitation expenses related to director elections. Rule 14a-8(i)(8) under the Securities Exchange Act of 1934 allows a company to exclude from its proxy materials stockholder proposals that may result in a contested election of directors, including proposals to amend the company’s bylaws to establish a procedure that may result in a contested election. However, the Chairman of the Securities and Exchange Commission, Mary Schapiro, recently suggested that this rule is likely to be amended in the near future. In a recent speech she stated that, as part of the “immediate agenda,” the SEC will propose several proxy access alternatives to ensure that shareholders have a meaningful opportunity to nominate directors. Chairman Schapiro further indicated that the propos-

als would likely include a “direct access” rule and a mechanism to allow shareholders to submit access bylaw proposals.

In light of Chairman Schapiro’s recent comments, it is very possible that companies that receive proposals during the 2010 proxy season regarding proxy access, and reimbursement of proxy expenses, related to director elections will need to include

them in their proxy statements (unless a basis for excluding such proposals, other than Rule 14a-8(i)(8), exists under Rule 14a-8) and decide how to respond to such proposals. Accordingly, monitoring the SEC’s proposals and actions regarding proxy access will be important to companies in preparing, and managing access to, their proxy materials.