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BUSINESS LAW CLIENT E-ALERT

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AMENDMENTS TO DELAWARE GENERAL CORPORATION LAW EFFECTIVE AUGUST 1, 2009

On April 10, 2009, Delaware Governor Jack Markell signed into law a bill amending certain provisions of the Delaware General Corporation Law (DGCL). The amendments will become effective on August 1, 2009. Although certain of these amendments will automatically apply to all Delaware corporations, most of them simply authorize the voluntary inclusion of certain previously questionable provisions in a corporation's organizational documents. And while these amendments will be applicable primarily to public Delaware corporations, they may, because of the influence of the DGCL on other states' corporate laws, also be of interest to smaller corporations, corporations organized under the laws of other states, investors, and members of boards of directors.

INDEMNIFICATION OF DIRECTORS, OFFICERS, AND EMPLOYEES

Delaware corporations do not have any statutory obligation to indemnify directors, officers, or employees for acts or omissions that occur during their watch. However, employers often find it difficult to recruit the best and brightest without promising some degree of indemnification, either pursuant to contractual provisions or under the corporation's organizational documents. In addition, corporate by-laws often provide for an obligation to advance expenses to an officer or director named in a lawsuit arising from the individual's service to the corporation, provided that the individual promises to repay such advancements in the event it is ultimately determined by a court that the individual was not originally entitled to reimbursement due to, for example, a determination that such individual breached her duty of loyalty to the corporation. The DGCL outlines certain outside parameters regarding the maximum extent to which a corporation may indemnify its directors, officers, agents, and employees, but the initial decision as to whether to indemnify at all still lies with the corporation. It is very common for a corporation's organizational documents to allow or require indemnification to the fullest extent

permissible under the DGCL. An important factor in determining the effective scope of the protection offered by the corporation is whether existing indemnification provisions can later be scaled back. Absent a prohibition on future changes to indemnification protections that existed at the time a director or officer joined the corporation, potential directors and officers might have legitimate concerns over whether such protections are meaningful.

Under an amendment to Section 145 adopted by the Delaware legislature and effective August 1, 2009, no right to indemnification or to advancement of expenses arising under a provision of a corporation's organizational documents may be eliminated or impaired by an amendment to any such provision after the occurrence of the event based upon which the indemnification or advance is sought unless the provision in effect at the time of the event explicitly authorizes the corporation to retroactively eliminate or impair such rights. If a corporation's organizational documents already contain provisions authorizing or requiring indemnification, the prohibition on retroactive elimination and impairment contained in this DGCL amendment would apply automatically. If a corporation wants the future ability to scale back indemnification rights retroactive to the event that gave rise to the indemnification obligation, it must include explicit authorization as contemplated in the amendment. Corporations desiring to provide the maximum possible director and officer indemnification coverage permitted by law (which is the case for the vast majority of corporations) need not take any action based on this amendment.

SHAREHOLDER NOMINATION OF DIRECTORS – ACCESS TO PROXY SOLICITATION MATERIALS

Currently, stockholders seeking to elect board members different than those nominated by the existing board must go through a generally lengthy proxy solicitation process and must foot the corresponding bill themselves. Under the soon to be enacted DGCL Section 112, a corporation may include in its by-laws a provision stating that shareholder nominations of directors may be included in a corporation's proxy statement that includes nominations made by the board of directors.

If such a right is included, the by-laws may also set parameters restricting how and by whom such a nomination may be made. Examples of permissible restrictions include:

- minimum levels or durations of stock ownership;
- consideration of whether stockholders have previously sought inclusion of nominations; and
- carve-outs for situations in which board nominations are made in connection with an acquisition.

In addition, under Section 113, corporate by-laws may include a provision allowing the corporation to reimburse stockholders for expenses incurred in connection with nominating directors via a proxy solicitation. Please note that no additional stockholder rights are created automatically by virtue of this amendment; additional rights will only become effective if a corporation amends its by-laws to include any of the outlined provisions.

Please also note that a public company's proxy materials are also subject to SEC proxy regulations, and that there are recently proposed amendments to these regulations, which, if adopted, would make mandatory the inclusion in company proxy materials of certain

shareholder nominations of directors. Public comments to these proposed SEC regulations are due in mid-August, and a lively debate is sure to follow. Current SEC regulations permit (and in certain situations may require) a company to exclude stockholders' slates of directors from proxy materials prepared by the company, and there has been some commentary calling into question the practical effect of the new DGCL amendment in light of the current SEC rules.

The optimal balance between constructive versus intrusive stockholder participation in the director nomination process remains a hotly debated question. But once a corporation determines for itself the extent to which it wants to encourage or discourage such participation, it will now have some additional leeway in defining the landscape. Whether the final SEC rules will make mandatory the currently permissive shareholder proposals contemplated in the new DGCL amendments remains to be seen.

DETERMINATION OF RECORD DATES FOR NOTICE AND VOTING

Presently, by virtue of the provisions contained in several interrelated DGCL provisions (Sections 211, 213, 219, 222, 228, 262, and 275), a single record date must be established both for the purpose of determining which stockholders must be given notice of a stockholder meeting and for the purpose of determining which stockholders are entitled to vote at the meeting. This can lead to the odd result of having certain former stockholders being able to vote even though they no longer hold company stock. Amendments to these DGCL sections will allow a corporation to establish separate record dates with respect to notice and voting. The parameters for permissible record dates for notice of stockholder meetings will remain as they are currently – no more than 60 nor less than 10 days prior to the meeting. With respect to voting, however, the amendments will permit the record date to be any date on or before the date of the meeting.

Whether there will be separate record dates with respect to notice and voting and, if so, when they will occur should be specified in the corporation's directors' resolutions calling the meeting. Although the new bifurcation of notice and voting record dates is automatic and does not have to be specified in a corporation's by-laws, most by-laws specify only a single record date, which could, in light of this series of amendments, create some confusion. If a corporation subscribes to the radical concept that only stockholders should be able to vote at stockholder meetings and desires to take advantage of this new flexibility, it should review its by-laws to verify whether there is any ambiguity and, to the extent there is, amend the by-laws accordingly.

JUDICIAL REMOVAL OF DIRECTORS

Finally, under Section 225(c), the Delaware Court of Chancery may remove a director of a corporation if the director has been convicted of a felony in connection with his corporate duties or has been judged to have committed a breach of his corporate duty of loyalty, and the Court of Chancery determines that the director did not act in good faith and that removal is necessary to avoid irreparable harm to the corporation. Application for removal must be made by the corporation or derivatively in the right of the corporation by a stockholder. There have been numerous instances where directors convicted of felonies and arguably causing irreparable harm to the corporation have remained as directors. Delaware courts now have the authority to remove such individuals by petition where the stockholders by vote have been unable to do so.

CONTACT

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