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Corporate Governance Group Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SINGAPORE TOKYO WASHINGTON, DC

PROPOSED AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW CREATE FLEXIBILITY FOR CORPORATIONS WHO DESIRE (OR BECOME REQUIRED) TO PERMIT STOCKHOLDER PROXY ACCESS

Proposed Amendments also will (i) Facilitate Reimbursement of Stockholder Proxy Expenses; (ii) Permit Separation of Record Dates for Rights to Notice of and to Vote at Stockholders Meetings; and (iii) Provide Additional Protections for Director Indemnification and Advancement Rights

Historically, the Delaware Corporation Law Council of the Delaware State Bar Association has been relatively nimble in proposing, and the Delaware General Assembly in adopting, amendments to the General Corporation Law (“DGCL”) that either anticipate, or respond to, judicial and regulatory developments and changing trends in corporate governance. To some extent, this reflects a desire to head off possible pre-emption by Federal lawmakers or regulators in areas traditionally handled at the state level. For instance, when majority voting for directors became a popular issue among institutional stockholders and corporate governance activists earlier this decade, the DGCL was amended to permit (although, notably, not require) corporations to adopt charter provisions to facilitate this new phenomenon.¹

No doubt reflecting a desire to remain “ahead of the curve,” as well as to respond to judicial decisions that could be viewed as making service as a director less appealing, the Delaware General Assembly is currently considering a new round of amendments to the DGCL.² If adopted, these amendments will afford Delaware corporations a high degree of flexibility to address several important corporate governance issues:

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¹ For a discussion of the differences between plurality and majority voting for directors and the Delaware response to the trend toward majority voting, see our Client Alert entitled “Recent Developments Involving Majority Voting in Director Elections” (February 22, 2006).

² See Del. State Senate 145th Gen. Assemb. S.B. (Feb. 2008).

- Proposed Section 112 would provide corporations with a mechanism to allow inclusion in their proxy materials of stockholder-nominated director candidates, subject to various conditions.
- Proposed Section 113 would permit the bylaws of corporations to provide for corporate reimbursement of expenses incurred by stockholders in soliciting proxies for director candidates, subject to various conditions.
- Proposed amendments to Section 213(a) would allow corporations to separate the record date for determining the stockholders entitled to *notice of* a meeting from the record date for determining those stockholders entitled to *vote at* the meeting.
- Finally, in response to a recent Delaware Court of Chancery decision,³ amended Section 145(f) would provide that corporations cannot impair or eliminate a director's right to indemnification or advancement of expenses by amending the relevant provision of their certificates of incorporation or bylaws *after* the occurrence of the related act or omission, unless the right to do so has been explicitly retained *prior to* the occurrence of such act or omission.

Stockholder Proxy Statement Access and Expense Reimbursement

Stockholder Proxy Access

In recent years, the Securities and Exchange Commission has discussed, but has not gone forward with, proposed rules that would provide stockholders with access to corporations' proxy statements for the purpose of nominating their own director candidates.⁴ Stockholder proxy access certainly remains an important issue for many institutional investors and corporate governance activists, and with the ascendance of a new administration in Washington, the issue has returned to the "front burner" at the Commission. In fact, it was recently reported that newly-appointed SEC Chairman Mary J. Shapiro has directed the Commission's Staff to draft proposals for rules governing stockholder proxy access.

Seemingly in anticipation of the Commission adopting rules requiring stockholder access in one form or another, or the possibility that corporations may voluntarily, or under pressure, adopt stockholder access bylaws, the proposed DGCL amendments create a mechanism for stockholder access that corporations may (but will not be required to) adopt. Specifically, the proposed amendments create Section 112, which would provide that if a corporation solicits proxies with respect to a director election (as publicly-traded corporations generally do on an annual basis), its bylaws *may* require the corporation to include stockholder-proposed nominees in its proxy materials alongside those nominated by the board of directors.

Section 112 also would set forth a non-exclusive list of conditions upon which the corporation may limit proxy access, including provisions: (i) requiring minimum record or beneficial ownership levels or duration of ownership by the nominating stockholder (which may define beneficial ownership "to take into account options

³ See our Client Alert entitled "Corporate Bylaws May Not Serve as Sufficient Protection for Directors Seeking Advancement of Litigation Expenses" (April 23, 2008).

⁴ See our Client Alerts entitled "SEC Proposes Rules Enabling Shareholders to Include Nominees in Company Proxy Materials" (October 24, 2003) and "SEC Amends Proxy Rules to Permit Exclusion of Shareholder Proposals Seeking Access to Company Proxy Materials for Director Nominations" (December 13, 2007).

or other rights in respect of or related to such stock”⁵); (ii) requiring information concerning the nominating stockholder and the nominating stockholder’s nominees; (iii) conditioning access on the number or proportion of directors nominated by the stockholders or on whether the nominating stockholder has previously sought access; (iv) precluding access if the nominating stockholder (or any affiliate or associate) has acquired, or publicly proposed to acquire, a specified percentage of the corporation’s outstanding voting stock within a specified period before the election; (v) requiring that the nominating stockholder agree to indemnify the corporation for any loss arising from any false or misleading statement in connection with such stockholder’s nomination; and/or (vi) “[a]ny other lawful condition.”

Expense Reimbursement

In July 2008, the Delaware Supreme Court considered the efficacy of a stockholder-proposed bylaw that would have required CA, Inc. to reimburse expenses incurred by stockholders in waging a successful director election campaign.⁶ The Court held that although stockholders are, as a general matter, entitled to submit proposed bylaws for consideration at annual stockholder meetings, the proposed bylaw, if adopted, could cause CA’s directors to be in breach of their fiduciary duties by requiring them, *under all circumstances*, to reimburse such expenses. In the Court’s view, Delaware law requires that such a bylaw “reserve to ... directors their full power to exercise their fiduciary duty to decide whether or not it would be appropriate, in a specific case, to award reimbursement at all.”

To address this issue (at least in part), but without requiring Delaware corporations to provide for stockholder expense reimbursement under any particular circumstance, the proposed amendments create Section 113, which would permit corporations to include in their bylaws a provision requiring reimbursement of stockholders for their expenses incurred in soliciting proxies for election of their director candidates. Much like proposed Section 112, proposed Section 113 would set forth a non-exclusive list of conditions a corporation may impose on a stockholder seeking reimbursement, including: (i) conditioning eligibility on the number or proportion of directors nominated by the stockholder, or on whether the stockholder previously sought reimbursement for similar expenses; (ii) limiting the amount of reimbursement to the proportion of votes cast in favor of the person nominated by the stockholder, or to the amount spent by the corporation in soliciting proxies in favor of the board’s candidates; and/or (iii) “[a]ny other lawful condition”.

Separation of Record Dates for Notice and Voting

Under the proposed amendment of Section 213(a), a corporation would be allowed to separate the record date for determining stockholders entitled to *notice of* a meeting from the record date for determining those stockholders entitled to *vote at* the meeting.⁷ On this basis, a board of directors could set the record date for determining the stockholders entitled to notice of the meeting on a date *preceding* the record date for determining those stockholders entitled to vote at the meeting. Further, the corporation would have the

⁵ This expanded definition of “beneficial ownership” arises from the use by hedge funds and other investors of various types of swaps and other derivatives to simulate stock ownership, as discussed in *CSX Corporation v. The Children’s Investment Fund Management (UK) LLP, et. al.*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008). For a discussion of the *CSX* decision, see our Client Alert entitled “Federal District Court Rules that Hedge Funds have ‘Beneficial Ownership’ of CSX Corporation Shares Underlying Equity Swaps” (June 19, 2008).

⁶ *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. Ch. 2008). For a discussion of this case, see our Client Alert entitled “Delaware Supreme Court Rules that Shareholder-Proposed Bylaw is Proper Subject for Shareholder Action” (July 25, 2008).

⁷ Conforming changes also are proposed to Sections 211, 219, 222, 228, 262 and 275.

latitude to set the record date for determining those entitled to vote up until the date of the meeting itself, and consequently, more accurately reflect the stockholder constituency at the time of the meeting. On the other hand, if a board of directors prefers not to separate the record dates, the default rule would provide that once a record date for providing notice is fixed, it will serve as the record date for determining *both* entitlement to notice of the meeting and entitlement to vote at the meeting.

This change represents a logical step for companies who disseminate proxy materials to stockholders electronically.⁸ These companies will be better able to ensure that new investors who purchase shares after the record date for notification of a meeting, but prior to the record date for entitlement to vote, will have ready access to the related disclosure materials without, as a general matter, having to mail them hard copies.

Indemnification and Advancement Rights

Lastly, a proposed amendment to Section 145(f) addresses the Court of Chancery's 2008 ruling in *Schoon v. Troy Corporation*.⁹ In *Schoon*, the Court held that a former director was not entitled to advancement of his litigation expenses because the provision of the corporation's bylaws granting that right was eliminated in an amendment adopted *after* the director left office, but *before* the claims against him were initiated.

Amended Section 145(f) would respond to *Schoon* by providing that a right to indemnification or advancement contained in a certificate of incorporation or bylaw provision cannot be eliminated or impaired by an amendment adopted *after* the occurrence of the act or omission that is the subject of the litigation, administrative action or investigation for which indemnification or advancement is sought. However, the amended section also would provide that the right to indemnification or advancement in such circumstances can be eliminated or impaired if the certificate of incorporation or bylaw provision — as in effect *before* the occurrence of such act or omission — contains an explicit authorization of such an elimination or impairment.

* * *

As in the past, amendments have been proposed to the DGCL which would provide corporations with flexibility to anticipate or respond to the latest developments in the ever-evolving world of corporate governance, as well as address recent judicial decisions that were not well received by directors of Delaware corporations and practitioners. It is important to note, however, that the DGCL section changes discussed in this Client Alert are currently proposed amendments and require no immediate action. Directors, managements and their advisors would nevertheless be well advised to follow the legislative progress of the proposed amendments, and consider whether developments impacting corporations generally, or their corporations in particular, warrant authorizing amendments to their certificates of incorporation or bylaws once the amendments are finalized and become part of the DGCL.

⁸ For a discussion of the Commission's electronic disclosure rules, see our Client Alerts entitled "SEC Adopts New Rules Permitting Web Posting of Proxy Materials" (February 14, 2007); "SEC Adopts New Rules Requiring Issuers to Post Proxy Materials on Internet Web Sites" (September 5, 2007); and "SEC Issues Interpretive Guidance Regarding Use of Company Web Sites" (August 22, 2008).

⁹ *Schoon v. Troy*, 948 A.2d 1157 (Del. Ch. 2008). For a discussion of this case, see our Client Alert discussed in note 3 above.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root +86-10-5969-2777 aroot@milbank.com
Edward Sun +86-10-5969-2772 esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger +49-69-71914-3453 nrieger@milbank.com

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root +852-2971-4842 aroot@milbank.com
Joshua Zimmerman +852-2971-4811 jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England

Stuart Harray +44-20-7615-3083 sharray@milbank.com
Thomas Siebens +44-20-7615-3034 tsiebens@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017

Ken Baronsky +1-213-892-4333 kbaronsky@milbank.com
Neil Wertlieb +1-213-892-4410 nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoefer)
80539 Munich, Germany

Peter Nussbaum +49-89-25559-3636 pnussbaum@milbank.com

New York

One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman +1-212-530-5149 sedelman@milbank.com
Roland Hlawaty +1-212-530-5735 rhlawaty@milbank.com
Thomas Janson +1-212-530-5921 tjanson@milbank.com
Robert Reder +1-212-530-5680 rreder@milbank.com
Alan Stone +1-212-530-5285 astone@milbank.com
Douglas Tanner +1-212-530-5505 dtanner@milbank.com

Singapore

30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans +65-6428-2555 dzemans@milbank.com
Naomi Ishikawa +65-6428-2525 nishikawa@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Darrel Holstein +813-5410-2841 dholstein@milbank.com
Bradley Edmister +813-5410-2843 edmister@milbank.com

Washington, DC

International Square Building, 1850 K Street
Washington, DC 20006

Glenn Gerstell +202-835-7585 gerstell@milbank.com