Corporate Governance of Delaware Corporations

Delaware Adopts Amendments to the Delaware General Corporation Law Relating to Corporate Governance

SUMMARY
The Delaware legislature has enacted a number of amendments to the Delaware General Corporation Law (the “DGCL”) relating to the governance of Delaware corporations. The amendments address current corporate governance issues concerning: (i) proxy access and expense reimbursement; (ii) director indemnification and advancement of expenses; (iii) judicial removal of directors; and (iv) flexibility in setting record dates by providing that the record date for mailing the notice of meeting need not be the same as the record date for determining stockholders entitled to vote. The effective date of the amendments is August 1, 2009.

PROXY ACCESS AND EXPENSE REIMBURSEMENT
The amendments include the addition of two new provisions that relate to permissible bylaw provisions governing proxy contests. The effect of these changes is not to mandate either proxy access or expense reimbursement (unlike North Dakota’s 2007 statute which does so), but rather to provide a list of non-exclusive provisions that might be contained in a bylaw addressing proxy access or proxy solicitation expense reimbursement. As such, the amendments make no change in the Delaware law—properly constructed bylaws containing such provisions would almost certainly have been permissible under Delaware law prior to the adoption of these provisions. Nor do the amendments mandate the restrictions that are suggested—the statute simply provides that a bylaw may contain certain procedures or conditions, and lists a number of potential provisions. Adoption of these provisions does nonetheless clarify that under Delaware law, issuers may impose restrictions on proxy access and proxy expense.
reimbursement bylaws, which may influence, as a practical or legal matter, any future federal legislation or rule-making on the subject.

**New Delaware Provisions on Bylaws Concerning Stockholder Access to Proxy Materials**

The amendments include a new Section 112, which states that a corporation’s bylaws may provide that if the corporation solicits proxies with respect to an election of directors, the corporation may be required to include individuals nominated by stockholders, in addition to individuals nominated by the board of directors. The new statute provides that the right of access to the corporation’s proxy materials may be conditioned on a number of factors or procedures, which may include the following:

- Minimum record or beneficial ownership, or duration of ownership, of shares of the corporation’s capital stock. The bylaws may define beneficial ownership to take into account options or other rights in respect of or related to the corporation’s capital stock.
- Submission of specified information concerning the stockholder and the stockholder’s nominees, including information concerning ownership by such persons of shares of the corporation’s capital stock, or options or other rights in respect of or related to such stock.
- Eligibility for inclusion in the proxy materials based on the number or proportion of directors nominated by the stockholder or whether the stockholder previously sought to require access to the corporation’s proxy materials.\(^1\)
- Prohibitions on nominations if the nominating stockholder, the stockholder’s nominee or any affiliate or associate of the nominating stockholder or nominee has acquired, or has publicly proposed to acquire, shares constituting a specified percentage of the voting power of the corporation’s outstanding voting stock within a specified period before the election of directors.
- A requirement that the nominating stockholder undertake to indemnify the corporation for any losses arising as a result of any false or misleading information or statement submitted by the nominating stockholder.

Proxy access, whereby a stockholder wishing to nominate a director can do so on the issuer’s proxy statement, has been a topic of considerable debate over the past several years. Rule 14a-11, which would have permitted it in certain cases for 5% or greater stockholders of SEC-reporting companies, was proposed by the Securities and Exchange Commission in 2003 but never adopted. More recently, in 2007, following a Second Circuit decision rejecting the Commission Staff’s position that a proxy access bylaw could be excluded from the issuer’s proxy statement under Rule 14a-8,\(^2\) the Commission proposed two mutually exclusive alternative rules, one of which would have permitted, albeit with considerable procedural and disclosure requirements, a greater than 5% stockholder to propose a bylaw amendment requiring proxy access under Rule 14a-8, and the other of which maintained the prior Staff position that

\(^1\) The synopsis included by the Delaware legislature along with the legislation describes this provision as permitting the bylaws “to limit a right of access according to whether or not a majority of board seats is to be contested,” but the statute itself is broader than that.

\(^2\) *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).
such a proposal was related to the election of directors and therefore excludable. After considerable comment, and with a split decision on the Commission, the rule upholding the exclusion of such proposals under 14a-8 was adopted.

It should be noted that stockholders of Delaware corporations are permitted to propose and adopt bylaws, including one which would mandate proxy access, without any prior approval of the board of directors. Thus, the only debate on adopting a bylaw requiring proxy access concerns the cost and mechanics of soliciting proxies for such a proposal. If the bylaw proposal could be included in the issuer's proxy statement under Rule 14a-8, there would be a minimal cost to the proposing stockholder. Nothing in federal or state law today would prohibit a stockholder of a Delaware corporation from filing and using its own proxy materials to propose a properly constructed proxy access bylaw at the annual meeting, provided the stockholder complied with any advance notice bylaw the issuer had in place. Moreover, nothing in the Delaware provisions recently adopted either (i) require the issuer to make its proxy statement available to such a bylaw proposal or (ii) prevent the stockholders of a Delaware corporation from adopting a bylaw proposed by a proxy access proponent that contained none of the enumerated conditions or restrictions, or from amending a bylaw that the Board of a Delaware corporation had adopted that contained such conditions and restrictions to remove such conditions and restrictions, unless such restrictions were necessary to make the bylaw valid under Delaware law.

New Delaware Provisions on Bylaws Concerning Reimbursement of Proxy Solicitation Expenses

The amendments include a new Section 113, which provides that the bylaws may require reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies for an election of directors, subject to such procedures or conditions as the bylaws may require. Section 113 also provides the following non-exclusive list of permissible requirements that the bylaws may prescribe as a condition to the right of a stockholder to demand reimbursement:

- Conditioning eligibility on the number or proportion of persons nominated by the stockholder seeking reimbursement or whether the stockholder previously sought reimbursement for similar expenses.
- Limitations on the amount of reimbursement based upon the proportion of votes cast in favor of one or more of the persons nominated by the stockholder seeking reimbursement, or on the amount spent by the corporation in soliciting proxies in connection with the election.
- Limitations concerning elections of directors by cumulative voting.

Contrary to the treatment of proxy access bylaws, the Staff of the Commission has not permitted the exclusion from public company proxy statements of precatory proposals requesting the board to adopt bylaws providing for the reimbursement of expenses of third parties soliciting proxies in election contests,

3 Meaning one drafted to avoid invalidation on the grounds that the bylaw violates Delaware law. See the discussion of the CA, Inc. decision below.

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despite the argument of issuers that this is also “related to the election of directors”. A binding bylaw proposal was held excludable after the Delaware Supreme Court held that the bylaw violated Delaware law in that it did not permit the board of directors not to reimburse expenses where to do so would violate their fiduciary duties.4 New Section 113 does not expressly require, or even include in the list of potential requirements, that the board be permitted to withhold expense reimbursement as necessary pursuant to its fiduciary duties, and it is unclear whether the adoption of new Section 113 overrides the Court’s determination that such discretion is required under Delaware law.

Expense reimbursement provisions generally are addressed to so-called “short slates”, because parties who gain control of the board have the ability to reimburse themselves, and such proposals often provide for partial reimbursement where the nominating stockholder has received a substantial vote, although not electing any directors.

**DIRECTOR INDEMNIFICATION AND ADVANCEMENT OF EXPENSES**

The Delaware legislature amended Section 145(f) of the DGCL in response to concerns raised by practitioners and directors following the highly publicized decision in *Schoon v. Troy Corp.*, 948 A.2d 1157 (Del. Ch. 2008), in which a Delaware court held that, under the indemnification bylaw in question, a former director’s expense advancement rights did not vest until the director was named as a defendant in a suit in which an indemnifiable claim was asserted. The *Schoon* court upheld a bylaw amendment that eliminated a former director’s right to advancement of expenses, despite the fact that the director served under the company’s previous bylaws and left the company’s board prior to the bylaw amendment that eliminated the right of advancement. The bylaw in question did not provide that the director was serving in reliance on the bylaw, that the right to indemnification was a contract right or that no amendments could be made to eliminate indemnification after an event had occurred giving rise to indemnification.

The amendment makes clear that a director’s right to indemnification or advancement of expenses under a company’s bylaws or certificate of incorporation vests at the time of the act or omission that is the subject of the indemnification or advancement of expenses. The amendment provides that such rights may not be eliminated or impaired by amendments to the bylaws or certificate of incorporation after the occurrence of the act or omission for which indemnification or advancement of expenses is sought, unless the provision in effect at the time of the act or omission contains an explicit authorization of such retroactive elimination or limitation.

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DIRECTOR REMOVAL

The amendments include the addition of a new subsection (c) to Section 225, which authorizes the Delaware Chancery Court, upon application by the corporation or the corporation’s stockholders on behalf of the corporation, to remove a director from office in certain circumstances involving criminal convictions or judgments related to breaches of the duty of loyalty to the corporation. Under the proposed amendment, the Court must make a determination that the director did not act in good faith and that judicial removal is necessary to avoid irreparable harm to the corporation.

MULTIPLE RECORD DATES FOR A MEETING

A new subsection (a) to Section 213 has been adopted, together with other conforming technical changes, which will allow a corporation’s board of directors to fix separate record dates for determining the stockholders entitled to receive notice of a meeting and the stockholders entitled to vote at the meeting. The amendment authorizes the board of directors to choose a date that is later than the notice record date, including the date of the meeting, as the record date for stockholders entitled to vote, provided they do so at the time of establishing the notice record date. This amendment recognizes that under the pre-existing law, where the single record date was set as much as 60 days prior to the meeting, or even longer if the meeting was adjourned, given the trading in the stock in the interim, the parties entitled to vote may no longer have any economic interest in the corporation. In addition to having significant decisions made by parties with no interest in the outcome, the prior statutory scheme often resulted in far fewer votes being received, as selling stockholders had no interest in voting.

INTERPLAY OF DELAWARE LAW CHANGES WITH FEDERAL PROXY RULES AND EXCHANGE REQUIREMENTS

Public companies that enact provisions described by these amendments to Delaware law will face a number of issues under the federal proxy rules, and potentially stock exchange requirements, which were not drafted to contemplate multiple record dates or a proxy card reflecting more nominees than seats available from multiple proponents.

Multiple Record Dates.

Rule 14a-13 of the Commission’s proxy rules requires a registrant to make inquiry of brokers and other nominees at least 20 business days “prior to the record date of the meeting of security holders” as to the numbers of sets of materials the fiduciary will require. Issuers may, in practice, need to make this inquiry

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5  This provision would not affect voting by persons who retain share ownership of record but have divested economic ownership through a derivative transaction.
with respect to both the notice and the voting record dates to ensure appropriate circulation of proxy materials. The proxy rules require the mailing (or electronic delivery) to all stockholders from whom a proxy is solicited, which could necessitate two mailings of proxy materials for two record dates. Instruction D.3 to Schedule 14A provides that if certain information is incorporated by reference in a proxy statement, the proxy statement must be sent to security holders no later than 20 business days prior to the meeting date—it should be presumed that security holders here means the stockholders entitled to vote, which would limit the registrant’s ability to incorporate information in the proxy statement yet have a record date closer to the meeting date. While the New York Stock Exchange does not mandate a minimum period between the record date, the NYSE recommends in Section 401.03 of the NYSE Listed Company Manual a minimum of 30 days be allowed between the record date (again, presumably meaning the voting record date) and the meeting date so as to give ample time for the solicitation of proxies.

“Universal” Proxy Card.

While a proxy card with more names than positions and proposed by multiple parties does not on its face violate the Commission’s proxy rules, assuming all nominees have consented to being named in the proxy statement and to serve if elected, as required by Rule 14a-4(d)(4), it does raise numerous issues for public companies pending any Commission guidance, including the following:

- Inclusion of more nominees than available seats increases the likelihood of error or confusion by stockholders in completing proxy cards (e.g., selecting more nominees than there are available seats). Management will need to consider in what cases it may disregard unclear instructions or interpret the instructions in these cases, and may need to describe the process in the proxy statement. At present, many stockholders simply sign and return a proxy card, and the proxy card makes it clear in that case that the management’s nominees will be voted for. It is unclear whether such a result would be permissible where the card includes both management and stockholder nominees.

- Must all nominees be included on a single card, or can the issuer, or the nominating stockholder, prepare and disseminate a second card with only its nominees?

- To what extent will the activities and communications of the nominating stockholders (e.g., preparing and disseminating their own cards with a short slate, or engaging in activities intended to result in the procurement, withholding or revocation of the issuer’s proxy card) be subject to the Commission’s proxy rules? Rule 14a-2(b)(1) provides an exemption from many of the Commission’s proxy requirements for a solicitation “by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another’s behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.” This exemption does not apply to, among others, any person acting on behalf of the issuer or a nominee or someone with a substantial interest the subject matter who is likely to receive a benefit from a successful solicitation. There is limited guidance available on the application of these provisions to a nominating
stockholder in connection with a management proxy, and it is likely that the application would depend on the facts and circumstances around the stockholder’s relationship with the nominee and the company and the activities being engaged in. The 2007 proxy access rule (which would have permitted proxy access bylaws to be proposed under Rule 14a-8) would have required substantial disclosure by the nominating stockholder.

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