

Weil Briefing: Corporate Governance

April 15, 2009

Delaware Legislature Addresses Shareholder Access and Adopts Other Important Corporate Governance Provisions

In a comprehensive package of legislative changes, the Delaware General Assembly has moved swiftly to address some burning stockholder concerns, including proxy access and expense reimbursement for director-election contests. The amendments to the Delaware General Corporation Law respond to recent court decisions and SEC rule making initiatives relating to stockholder access and expense reimbursement. This legislative response signifies a move toward a more stockholder-friendly approach consistent with Delaware's internationally respected director-centric model of corporate governance.

The amendments, enacted last week and effective August 1, include a provision that a corporation's bylaws may require the corporation to include in its proxy solicitation materials stockholder-nominated candidates for the board of directors.¹ The Act states that the bylaws may provide procedures for or conditions to proxy access, including:

- minimum record or beneficial stock ownership or duration of ownership by the nominating stockholder
- submission by the nominating stockholder of specified information, such as information about stock ownership, about the stockholder and the stockholder's nominees
- eligibility requirements based on the number or proportion of directors nominated by stockholders or whether the stockholder previously sought inclusion of its nominees in the company's proxy materials
- preclusion of nominations by any person if that person or that person's nominee, or any affiliate, has acquired or has proposed to acquire a specified percentage of the corporation's voting power within a specified period before the election of directors
- a requirement that the nominating stockholder agree to indemnify the corporation for any loss arising out of any false or misleading information or statement submitted by the nominating stockholder in connection with a nomination.

The amendments also provide that a corporation's bylaws may provide for the reimbursement by the corporation of a stockholder's expenses incurred in soliciting proxies in connection with the election of directors.² The bylaws may provide procedures for or conditions to reimbursement, including:

- eligibility requirements based on the number or proportion of directors nominated by the stockholder seeking reimbursement or whether the stockholder previously sought reimbursement

- provisions tying the amount of reimbursement to the proportion of votes cast in favor of one or more of the stockholder's nominees, or to the amount spent by the corporation in soliciting proxies
- limitations concerning cumulative voting.

These new statutes may increase opportunities for stockholders to nominate candidates for the board, either by inclusion of stockholder-nominated candidates in the company's proxy materials or by shifting to the corporation the stockholders' cost of soliciting proxies. Bylaws may be adopted by stockholder action without the need for board approval, and bylaws following these statutory provisions would, by definition, be valid.³ Nevertheless, it is not yet clear how much impact the provisions will have. How widely bylaws of this nature will be adopted may depend on whether companies are required to include in their proxy materials stockholder proposals that seek to institute bylaws requiring proxy access or expense reimbursement.

SEC Rule 14a-8(i)(8) under the 1934 Exchange Act permits a company to exclude from its proxy materials a stockholder proposal that "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election."⁴ Under the SEC's current interpretation of that rule, a company would be permitted to exclude a stockholder proposal to adopt bylaws consistent with the new provisions of the DGCL. In adopting a recent amendment to Rule 14a-8(i)(8), the SEC explicitly stated that "Rule 14a-8(i)(8) permits exclusion of a proposal that . . . would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings."⁵

But earlier this month, SEC Chairman Mary Schapiro, in an address to the Council of Institutional Investors, referred to the then-pending legislation in Delaware and stated that in May "the Commission will consider a proposal to ensure that a company's owners have a meaningful opportunity to nominate directors."⁶ Chairman Schapiro's remarks may foreshadow a change in course in the SEC's application of Rule 14a-8 to exclude from the company's proxy materials stockholder proposals such as the bylaws authorized by new DGCL sections 112 and 113.⁷ If the Commission in fact changes its approach under Rule 14a-8(i)(8) relating to exclusion of stockholder-proposed bylaws governing election procedures, stockholder proposals seeking the adoption of bylaws consistent with the new Delaware access and reimbursement provisions are likely to be brought to a vote at many companies. Also, boards of directors may act proactively by adopting, after conferring with their significant stockholders, bylaws that provide for access or expense reimbursement on terms and conditions consistent with the new Delaware provisions that the board considers appropriate to the company's circumstances.

The new Delaware legislation also contains other important provisions, including: (a) rights to indemnification or advancement of expenses set forth in the certificate of incorporation or bylaws cannot later be impaired unless such impairment is provided for in the original charter or bylaw provision;⁸ (b) corporations may provide for separate record dates for notice purposes and voting purposes pursuant to several sections in the new Act;⁹ and (c) the Court of Chancery may remove directors from office for specified misconduct toward the corporation in an action brought by the corporation or derivatively on behalf of the corporation.¹⁰

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¹ H.B. 19, 145th Gen. Assem., § 1 (Del. 2009) (to be codified at DEL. CODE ANN. tit. 8, § 112).

² H.B. 19, 145th Gen. Assem., § 2 (Del. 2009) (to be codified at DEL. CODE ANN. tit. 8, § 113).

³ *Cf. CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 237, 238 (Del. 2008) (holding that a stockholder-proposed bylaw that would provide for reimbursement of expenses incurred by stockholders in connection with nominating candidates to the board was a proper subject for action by shareholders but, as drafted, “would violate the prohibition against contractual arrangements that commit the board of directors to a course of action that would preclude them from fully discharging their fiduciary duties to the corporation and its shareholders”); Weil Briefing: Corporate Governance, *Delaware Supreme Court Addresses Validity of Shareholder Bylaws: Answering Some Questions and Raising Others* (July 21, 2008).

⁴ 17 C.F.R. 240.14a-8(i)(8).

⁵ *See* Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 70,450, 70,453 (Dec. 11, 2007).

⁶ Mary L. Schapiro, Chairman, U.S. Sec. & Exchange Comm'n, Address to the Council of Institutional Investors (Apr. 6, 2009).

⁷ *Cf. AFSCME v. AIG*, 462 F.3d 121 (2d Cir. 2006) (holding that “a shareholder proposal that seeks to amend the corporate bylaws to establish a procedure by which shareholder-nominated candidates may be included on the corporate ballot does not relate to an election within the meaning of [Rule 14a-8(i)(8)] and therefore cannot be excluded from corporate proxy materials under that regulation,” and pointing to the SEC’s “interpretive shift[s]” in interpretation of the rule between 1976 and 2006).

⁸ H.B. 19, 145th Gen. Assem., § 3 (Del. 2009) (amending DEL. CODE ANN. tit. 8, § 145(f)).

⁹ H.B. 19, 145th Gen. Assem., §§ 4, 5, 6, 7, 8, 9, 11, 12, 13, 14 (Del. 2009) (amending DEL. CODE ANN. tit. 8, §§ 211(c), 213, 219, 222, 228(e), 262(b), (d), 275(a)).

¹⁰ H.B. 19, 145th Gen. Assem., § 10 (Del. 2009) (to be codified at DEL. CODE ANN. tit. 8, § 225(c)).