

From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

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Officer Exculpation Charter Amendments: A 2023 Proxy Season Review

Effective in August 2022, Section 102(b)(7) of the Delaware General Corporation Law (the DGCL) was amended to permit Delaware corporations to exculpate “covered officers,” providing such officers with certain protections traditionally available only to directors. Since then, over 200 publicly traded Delaware corporations have amended their certificate of incorporation (or charter) to adopt an officer exculpation provision. In this Alert, we evaluate the results of the 2023 proxy season, during which 279 public companies included a proposal in their annual meeting proxy statement requesting stockholder approval of a charter amendment to adopt an officer exculpation provision. We also take stock of factors that influenced the voting outcomes, including ISS and Glass Lewis recommendations, as well as considerations for companies that have not yet adopted officer exculpation as they look ahead to the 2024 proxy season.

Background: Amendment to DGCL Section 102(b)(7)

Prior to the August 2022 amendments, Delaware corporations were permitted to exculpate directors, but not officers, for breaches of the duty of care. In recent years, fiduciary duty claims, particularly in disclosure-related litigation, made against officers as well as directors, have significantly increased, highlighting the disparity in circumstances where directors are able to have such claims dismissed whereas the same claims against officers are permitted to proceed. As a result of the amendments to Section 102(b)(7) of the DGCL, Delaware corporations may now amend their charters to adopt exculpatory language effectively eliminating the personal liability of officers for monetary damages in connection with breaches of the fiduciary duty of care. Like directors, officers may not be exculpated for claims for breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, or any transaction from which the officer derived an improper personal benefit. However, unlike the protections available to directors, officer exculpation will only shield officers against direct claims brought by stockholders, but not against derivative claims brought by the board of directors. “Covered officers” include any individual who (1) is or was president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer; (2) is or was a “named executive officer” identified in the corporation’s filings with the SEC; or (3) has, by written agreement with the corporation, consented to be identified as an officer for purposes of accepting service of process.

2023 Annual Meeting Voting Results

Between August 1, 2022, when the amendment to DGCL Section 102(b)(7) became effective and July 5, 2023, 279 Delaware corporations included a proposal in their proxy statement requesting stockholder approval for a charter amendment to adopt an exculpatory provision for officers. Stockholders approved such proposal at 221 (79.2%) companies, and did not approve the proposals at 42 of the 279 companies (15.1%). The results of the votes at 17 companies remain outstanding at the time of this publication.

Generally, pursuant to Section 242 of the DGCL, a charter amendment requires the vote of a majority of the outstanding stock entitled to vote on the matter. For companies that require supermajority approval under their governing documents, the higher vote threshold proved to be a hurdle to stockholder approval. Specifically, 18 of the 42 proposals that failed required a supermajority vote, 13 of which would have passed had the Delaware default standard applied.

Impact of ISS and Glass Lewis

ISS and Glass Lewis amended their voting policies in 2023 in anticipation of officer exculpation charter amendment proposals. ISS will make recommendations on such proposals on a “case-by-case” basis, considering the stated rationale for the proposed change taking into account the extent to which the proposal would (i) eliminate directors’ and officers’ liability for monetary damages for violating the duty of care; (ii) eliminate directors’ and officers’ liability for monetary damages for violating the duty of loyalty; (iii) expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness; and (iv) expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts that previously the company was permitted to provide indemnification for, at the discretion of the company's board (i.e., “permissive indemnification”), but that previously the company was not required to indemnify.

Glass Lewis also evaluates such proposals on a “case-by-case” basis, but generally recommends voting “against” such proposals unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable.

ISS has largely recommended “for” the adoption of officer exculpation, while Glass Lewis has largely recommended “against.” ISS voting records indicate that as of July 5, 2023, ISS supported 224 of the 279 company proposals (80.2%) and recommended against 47 of the 279 proposals (16.8%), with 8 proposals awaiting an ISS recommendation at the time of this publication. Moreover, of the 47 companies that received a negative recommendation from ISS, 38 received sufficient stockholder support to approve the exculpatory provision, signaling that a negative recommendation does not significantly impact the ultimate result.

The stated reasons for ISS’ negative recommendations were largely fact-specific and included 30 controlled or “close to controlled” companies. ISS noted that in these instances, stockholders have no practical ability to amend governing documents against the wishes of the controlling stockholder and that decisions regarding the company’s response to stockholder litigation would be made by a board that lacks accountability. Other reasons for ISS’ negative recommendations include a company’s poor track record on corporate governance issues (13 companies) or having a dual class structure with no time-based sunset provision (7 companies).

Institutional investors have not weighed in with proxy voting guidelines on officer exculpation.

Litigation and Dual Class Companies

In the fall of 2022, Delaware litigation appeared to have slowed some of the momentum for companies wishing to adopt officer exculpation, particularly at companies with multiple classes of stock. The question at issue in these cases related to whether a separate class vote was required to approve an officer exculpation charter amendment.¹ In each case, plaintiff stockholders were part of a class of stockholders that were excluded from voting on a proposed charter amendment to adopt officer exculpation on the grounds that such class was not entitled to vote on the proposal. Plaintiffs challenged these actions on the grounds that the corporation violated Section 242 of the DGCL, which provides that if a corporation has more than one class of stock outstanding and a proposed amendment to the certificate of incorporation would “alter or change the powers, preferences, or special rights” of a class of stock so as to affect them adversely, then such amendment also must be adopted by a majority of outstanding stock of that class. The Delaware Court of Chancery granted summary judgment in March 2023, holding that a separate class vote of the non-voting stock was not required because the proposed officer exculpation amendments did not affect any “power, preference, or special right” of such class expressly set forth in the certificate of incorporation. The cases are currently on appeal with arguments expected later in 2023.

What to Do Now?

- **Consider whether and when to implement officer exculpation; consider lead-time.** Companies incorporated in Delaware that have not yet adopted officer exculpation should consider whether adopting an officer exculpation provision is beneficial to the company, balancing the likelihood of relevant litigation and success of the proposal given the facts and circumstances applicable to the company. The generally positive results during the 2022-2023 proxy season indicate overall strong stockholder support for officer exculpation proposals and it is likely that we will see more proposals next year. Companies should be prepared to allow for sufficient lead time as a charter amendment will require the filing of a preliminary proxy statement pursuant to Rule 14a-6.
- **Review governance documents; involve the governance committee.** Companies should review their governing documents and Delaware law to confirm the procedures for adopting officer exculpation through a charter amendment, including board approval and stockholder voting requirements. Companies should also review the 2022-2023 proxy season results, potential proxy advisory firm recommendations and the process for charter amendments pursuant to the company’s governing documents with the governance committee of the board of directors.
- **Develop clear rationale; consider previewing proposal during off-season engagement.** Companies wishing to adopt officer exculpation should develop their rationale early and purposefully. This will prepare the company to clearly articulate the benefits of this charter amendment in their proxy statements. Companies planning to or seriously considering amending their charter to provide for officer exculpation at their next stockholder meeting – especially those with supermajority voting provisions – should engage with stockholders on this topic during the fall engagement season.
- **Monitor ongoing pending litigation for dual-class companies.** Although the Delaware Chancery Court recently held that a charter amendment to provide for officer exculpation does not require a separate vote, as noted above, the decision has been appealed. In light of this pending litigation, companies with dual-class stock should monitor the outcome of the aforementioned appeal and should carefully weigh the pros and cons of not soliciting such a class vote.
- **Consider fiduciary duty and exculpation “refresh” for directors and officers.** The statutory amendment and adoption or consideration of a charter amendment to provide for officer exculpation provides an appropriate opportunity to provide a refresher to the board of directors and officers regarding recent Delaware case law relating to director and officer fiduciary duties and the limits of exculpation.

¹ Electrical Workers Pension Fund Local 103, I.B.E.W. v. Fox Corporation, Civil Action No. 2022-1007-JTL, and coordinated case In Re Snap Inc., Consolidated Litigation, Civil Action No. 2022-1032-JTL (Del. Ch. Mar. 29, 2023).

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