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Delaware General Corporation Law Updates—Stockholder Access to Proxy Materials

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On April 10, 2009, two new sections of the Delaware General Corporation Law (DGCL) were enacted regarding corporate governance and the rights of stockholders to access company proxy materials. Taking effect August 1, 2009, these amendments give Delaware corporations the right to adopt new bylaw provisions, which, among other things, grant stockholders greater access to a corporation's proxy solicitation materials. These changes are part of a trend toward lowering the barriers faced by stockholders to nominate directors and coincide with a proposed rule released by the Securities and Exchange Commission ("SEC") on May 20, 2009, to provide enhanced stockholder access to include director nominations in public company proxy materials.

Background

Stockholders of public companies generally have limited ability to nominate directors and include such nominations in the proxy solicitation materials distributed by corporations. Stockholders typically must carry out their own solicitation (and incur the associated expenses) or attempt to elect directors at stockholder meetings when the majority of votes have already been cast in advance of the meeting. An ongoing debate exists as to the relative power that should be afforded stockholders and corporate boards with respect to the nomination of directors and the ability of the stockholders to exercise "their fundamental right to nominate directors"¹ as part of the director election process.

With the addition of the two new DGCL sections, Delaware corporations may now include optional provisions in their bylaws that, under certain circumstances, grant stockholders access to a corporation's proxy solicitation materials and provide reimbursement of proxy solicitation expenses relating to the nomination of directors.

Access to Proxy Solicitation Materials (§ 112)

Prior to the adoption of these amendments, Delaware corporations did not have any obligation to include stockholder nominees in the proxy solicitation materials distributed by the corporation. While not mandatory, Section 112 provides that Delaware corporations may now elect to incorporate provisions into their bylaws allowing shareholders to have the right to include their nominees for the election of directors in the corporation's proxy materials. Corporations may, however, condition and restrict such access through adopting certain procedures, including:

- Requiring a minimum amount or duration of beneficial ownership of shares of the company's stock;

- Requiring a nominating stockholder to provide certain information relating to the stockholder and its nominees;
- Imposing conditions relating to the number or proportion of directors to be nominated;
- Containing restrictions if the stockholder or its nominee has acquired or publicly disclosed an intent to acquire a certain percentage of the corporation's stock prior to the election at issue; and
- Requiring the nominating stockholder to indemnify the corporation for any losses arising out of false or misleading statements in materials submitted by the nominating stockholder in connection with the proxy solicitation process.

While Section 112 provides stockholders an ability to present their nominees alongside the slate of nominees selected by the board of directors, it also makes clear that a corporation may limit such access by enacting reasonable protections. Furthermore, the foregoing protections ensure that corporations are able to prevent the nomination of more than a majority of the corporation's board of directors and otherwise preclude attempts at a change in control.

Reimbursement of Stockholder Solicitation Expenses (§ 113)

Section 113 allows stockholders who are submitting nominees for inclusion in corporate proxy solicitations to seek reimbursement of expenses incurred in connection with the election of directors. Section 113 essentially codifies the Delaware Supreme Court's decision in *CA, Inc. v. AFSCME Employees Pension Plan*² in which the Court determined that a stockholder-proposed bylaw amendment providing for reimbursement by the corporation of proxy expenses incurred by a stockholder was a valid proposal because it did not attempt to decide specific substantive business decisions, but instead set out to define the process and procedures by which those decisions are made. However, in *CA, Inc.*, when looking at the substance of the proposed bylaw provision, the Court determined that it was invalid because it did not contain a fiduciary out and, if adopted, directors might be contractually committed to reimburse expenses without exception and could therefore be precluded from fully discharging their fiduciary duties.

Similar to Section 112, Section 113 is an opt-in provision that corporations have the option to include in their bylaws. Corporations are also entitled to include in their bylaws certain conditions and restrictions on the reimbursement. Section 113 also contains a non-exhaustive list of potential conditions, including limitations on reimbursement based on:

- The number or proportion of directors nominated by the stockholder;
- Whether the stockholder has previously sought similar reimbursements;
- The proportion of votes cast in favor of the stockholder's nominees or the amount spent by the corporation soliciting the proxies; and
- Whether cumulative voting was in place for the subject election.

In addition, Section 113 precludes reimbursement claims arising prior to adoption of the Section 113 bylaw provision providing reimbursement.

Interestingly, Section 113 did not codify the fiduciary out requirement set forth in *CA, Inc.* Therefore, it remains to be seen whether courts will read-in such a requirement or, upon review, invalidate bylaws that do not contain an exception allowing directors to discharge their fiduciary

duties to the corporation and stockholders. Consequently, corporations that decide to utilize these provisions are advised to limit reimbursement to circumstances that are not inconsistent with a director's performance of his or her fiduciary duties.

Conclusion

With the recent market turmoil, stockholders are giving more and more scrutiny to the performance of corporate management. By adopting these new amendments to the DGCL, Delaware has set a precedent allowing greater access and affordability for stockholders to participate in the selection of directors. Taken together, these new sections have the potential to encourage activism among stockholders seeking to engage in proxy contests. Given these developments, corporations should evaluate the benefits and drawbacks of adopting such provisions and may be advised to enact conforming bylaw amendments proactively with the procedures and protections they deem appropriate.

¹ Mary Schapiro, Chairman of the SEC, in SEC Release 2009-116, dated May 20, 2009, entitled "SEC Votes to Propose Rule Amendments to Facilitate Rights of Stockholders to Nominate Directors." Available at: <http://www.sec.gov/news/press/2009/2009-116.htm>.

² *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008).

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