

Delaware Supreme Court Reaffirms Director Protections and Clarifies Revlon Duties in Sale Transactions

In an *en banc* decision, the Delaware Supreme Court in *Lyondell Chemical Company v. Ryan*, C.A. No. 401, 2008 (Del. Mar. 25, 2009) recently reversed the Delaware Court of Chancery and granted summary judgment to Lyondell's directors. The Supreme Court's decision clarifies directors' duties in the context of a sale transaction. Specifically, the decision provides guidance that:

- *Revlon* duties, which require a company's board to obtain the best price for stockholders at the sale of a company, arise at the time a company embarks on a transaction either by its own initiative or in response to an unsolicited offer that will result in a change of control of the company. *Revlon* duties do not arise simply because a company is "in play" as a result of a third party's actions.
- Given the unique combination of circumstances faced by directors in fulfilling their *Revlon* duties in pursuing a change of control transaction, there are no prescribed steps or blueprints that directors must follow. Rather, directors must be "reasonable" in carrying out their duties to obtain the best price.
- Exculpatory provisions for breaches of the duty of care (such as in Lyondell's certificate of incorporation and which are customarily included in certificates of Delaware corporations) provide independent and disinterested directors significant protection from monetary damages. While it may have been a triable issue of fact

The Supreme Court held that director's decisions must be "reasonable, not perfect" and only if the disinterested directors had knowingly and completely failed to undertake their responsibilities to attempt to obtain the best price would they breach their duty of loyalty.

as to whether the Lyondell directors breached their duty of due care, the exculpatory provision afforded them protection from personal liability. The Supreme Court went on to reinforce that a bad faith breach of loyalty in the sale context is very hard to prove and "an extreme set of facts is required to sustain a disloyalty claim." Directors do not breach their duty of loyalty by failing to act in good faith without a showing of intent to do harm or an intentional dereliction of duty.

Background

As early as April 2006, Basell AF expressed an ongoing interest in acquiring Lyondell Chemical Company. Lyondell believed the offering price of \$26.50-\$28.50 per share proposed by Basell was inadequate, and responded that it was not interested in selling the company. In May 2007, an affiliate of Basell filed a Schedule 13D with the SEC disclosing its continuing interest to acquire Lyondell. Immediately upon this disclosure, the Lyondell board convened a special meeting and decided to take a "wait and see" approach. On July 9, 2007, Basell's owner met with Lyondell's Chairman and CEO to discuss a deal that, after negotiations, resulted in a written offer by Basell of \$48 per share with no financing contingency, but required a \$400 million break-up fee and an executed merger agreement

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within seven days. The Lyondell board, all disinterested and independent directors, met twice in the following two days to review the valuation materials that were prepared for an upcoming regular board meeting and to discuss the Basell offer. The Lyondell board determined that it was interested and authorized the retention of a financial advisor and management to conduct additional negotiations with Basell.

The parties negotiated in the interim while the financial advisor prepared a “fairness” opinion. The board again met and instructed management to try to negotiate better terms, including (i) a higher price, (ii) a go-shop provision, and (iii) a reduction in the break-up fee. Basell responded that it had put forth its best offer and agreed only to lower the break-up fee by \$15 million.

The Lyondell board met again on July 16 to consider the Basell merger agreement and review the legal and financial advisor presentations. The board received an opinion by its financial advisor that the merger price was “fair” and the price offered by Basell was described by a managing director of its financial advisor as “an absolute home run.” The board’s legal advisors advised the board that even though management had been unsuccessful in negotiating a “go-shop” clause, the merger agreement contained a “fiduciary out” provision that would afford directors the ability to exercise their fiduciary duties and consider any superior proposals. The Lyondell board voted to approve the merger, which was subsequently approved by more than 99 percent of the voted shares.

A shareholder class action was filed in the Court of Chancery claiming the Lyondell board failed in performing its fiduciary duties with regard to the merger transaction. Specifically, the claim alleged that the merger price was grossly insufficient, the directors were motivated by self-interest, the negotiation process was flawed, the directors agreed to unreasonable deal protection provisions, and the preliminary proxy statement omitted numerous material facts. The Court of Chancery rejected all claims except with respect to whether the directors had acted in good faith in fulfilling their *Revlon* duties and whether the deal protection measures were preclusive.

Supreme Court Decision

In an interlocutory appeal by the directors, the Supreme Court rejected the Chancery Court’s decision denying

summary judgment. Because the Lyondell board was independent and disinterested, the issue before the Supreme Court was whether the directors breached their fiduciary duty of loyalty by failing to act in good faith. The Supreme Court cited three factors in holding that the Chancery Court approached the record from “a mistaken view of applicable law.”

Timing when *Revlon* Duties Attach: The Chancery Court imposed *Revlon* duties on the Lyondell directors prematurely. The Chancery Court cited the two months of inactivity by Lyondell directors between the filing of the Schedule 13D as critical to its analysis of their good faith. The Supreme Court, however stated that the *Revlon* duties do not arise merely when a company is “in play,” but rather when a company “embarks on a transaction, either of its own accord or in response to an unsolicited offer, that will result in a change of control.” Though the Schedule 13D may have put the public and the directors on notice, the time for action under *Revlon* did not begin until the directors began negotiating the sale of Lyondell on July 10, 2007. The directors “wait and see” approach was an entirely appropriate exercise of the board’s business judgment. The Supreme Court held that it was not until July 10, the date the board decided to engage in a sale transaction, that its *Revlon* duties commenced. The Chancery Court had acknowledged that the directors’ conduct during those seven days might not demonstrate anything more than a lack of due care, which would not survive summary judgment in light of the exculpatory provision.

Board Is Not Required to Follow Specific Steps in the Sale Process: The Chancery Court read *Revlon* and its progeny as creating a set of requirements that must be satisfied during the sale process. The Supreme Court made clear however that “there is only one *Revlon* duty – to get the best price for the stockholders at a sale of the company.” The \$48 per share price amounted to a 45 percent premium over the closing share price on the last trading day before the filing of the Schedule D and a 20 percent premium over Lyondell’s closing price on July 16, 2007, the day before the merger was announced. The Supreme Court noted that courts cannot tell directors exactly how to accomplish their goal of obtaining the highest price for stockholders due to the multitude of circumstances that directors may face in the sale transaction context, many of which will be outside of their control. The Supreme Court cited the director’s reliance on financial and legal advisors, the substantial premium paid by Basell and statements

made to the board regarding the purchase price in concluding that the directors did not consciously disregard their duties and violate their duty of good faith in conducting the sale process.

Standard for Reviewing a Disinterested Board's Actions in a Sale Transaction:

The Chancery Court incorrectly equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith. The Supreme Court stated that the proper inquiry was not if the directors had done everything they should have, but whether the disinterested and independent directors "utterly failed" to attempt to obtain the best sales price. The Supreme Court concluded that there is a "vast difference" between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties. The Supreme Court held that director's decisions must be "reasonable, not perfect" and only if the disinterested directors had knowingly and completely failed to undertake their responsibilities to attempt to obtain the best price would they breach their duty of loyalty.

In reviewing the record, the Supreme Court determined that because the board met several times to consider the offer; were generally aware of the value of Lyondell; solicited and followed the advice of their financial and legal advisors; attempted to negotiate a higher offer even though the evidence indicated that Basell had offered a "blowout"

price; and ultimately approved the merger agreement because it was simply too good not to be passed along to stockholders for their consideration. As such, the record clearly established that the directors did not breach their duty of loyalty by failing to act in good faith and reversed the Chancery Court's decision and remanded the case for entry of judgment in favor of the Lyondell directors.

The Delaware Supreme Court's decision reaffirms the deference afforded to decisions of independent and disinterested directors in the context of a sale transaction and that directors will receive broad protection from personal liability under exculpation clauses so long as they do not consciously disregard the fiduciary duties.

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Securities Lawyers: Beware of Clarity

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From their very first law school classes, lawyers are taught to research and rely upon precedent when determining how to interpret a given law. Litigators learn early that a statute is given its meaning by the cases that test it, not just by the treatises that explain the statute's rationale or the legislative history that accompanied its adoption.

For securities lawyers, precedent appears in the form of prior debt and equity financings, mergers, tender offers and other capital markets transactions. Another source of precedent is found in transaction-based guidance provided by the U.S. Securities and Exchange Commission (the SEC), as well as by the rules and regulations promulgated thereby. The "precedent" transactions and SEC interpretations that guide securities lawyers ultimately may not serve as binding precedent in court if litigation ensues. Nonetheless, it is understandable that securities lawyers look to "peer" transactions and SEC guidance when reaching a judgment that a particular transaction complies with securities laws.

One challenge when assessing securities law compliance is that, despite similarities or "resemblances" among capital markets transactions, most transactions include features, or reflect circumstances, that could differentiate significantly any one from the others. Perhaps, for example, in one transaction, the issuer is a "well known seasoned issuer," whereas in another seemingly similar transaction, the issuer only recently completed its initial public offering. Or, maybe, in one transaction, an operating subsidiary issues unsecured debt without a parent guaranty, while in another transaction, an operating subsidiary issues unsecured debt that is guaranteed by the parent.

In the absence of SEC guidance that is directly on-point, how is a securities lawyer to know whether and when such "transaction differentiators" change the result, or matter at all? How can a securities lawyer first identify those transaction features that make a difference and which, if not addressed, would expose a transaction to challenge from the SEC or an aggrieved stockholder?

Even when the SEC has addressed a particular issue, when counseling clients, corporate practitioners must be careful to identify the limits on inferences that can be drawn from such SEC guidance and to learn to recognize transaction aspects that can alter the compliance analysis.

Securities lawyers are faced with these difficult questions every day. It is no simple or easy task to research and analyze every recent "precedent" transaction, let alone to consider all of the nuances thereof. For that reason, when the SEC has spoken on a given topic, it is tempting to rely on the SEC's clear words as authority when assessing legal compliance. Even when the SEC has addressed a particular issue, when counseling clients, corporate practitioners must be careful to identify the limits on inferences that can be drawn from such SEC guidance and to learn to recognize transaction aspects that can alter the compliance analysis.

The SEC's Division of Corporation Finance (the Division) typically provides guidance, in the form of no-action letters and interpretive advice that is limited in scope to the facts presented to the Division. Moreover, the Division specifies that the guidance provided in the no-action letters is to be relied upon only by the addressee of the no-action letter and not by other parties, and the Division often in the no-action letters states that the Division expresses no opinion as to the merits of the analysis provided by the party that submitted the no-action letter. In this way, even the Division's clearest explanations often are narrow in scope and do not address all of the transaction variables or provide an overarching framework that is generalizable to other potentially analogous transactions. Identifying relevant "transaction differentiators" requires a close textual reading

of applicable rules and regulatory interpretations, but attention to detail is not enough. Imagination and expanding the scope of one's analysis beyond the written words also is required.

Consider the Division's Compliance and Disclosure Interpretations, Securities Act Section (November 26, 2008 Update) (the CDI). The CDI uses a straight-forward "question and answer" format, with the intention to simplify and address head-on many recurring issues encountered by securities lawyers. Each presented scenario, and the accompanying answer, is concise, fact-light, and, on its face, clear. Indeed, the brevity of each "Q&A" is enticing, for it seems to indicate that the guidance provided by such "Q&A" may be applied to a variety of transactions.

Because the questions posed are drawn from actual transactions, however, it is challenging for one to discern, or divine, the SEC's rationale that underlies each scenario. Without a comprehensive framework or decision tree that maps the SEC's analysis, it is unclear how much, and in what ways, each proposed transaction can be modified before the Division's guidance no longer applies. One cannot be certain in what circumstances one must look beyond the text of each "Q&A," and real transactions, unlike those appearing in the CDI, are fact-intensive. In that way, the clarity provided by the CDI may be deceptive. Corporate practitioners are well advised to consider SEC guidance, such as the CDI, not as containing the answer as to whether a transaction complies with securities laws, but, instead, as the baseline for their analysis and as one component of the applicable precedent.

Consider Q&A 103.01 of the CDI, addressing Securities Act Section 2(a)(3) to illustrate this proposition, which states:

“Question: If a company declares a dividend that is payable in either cash or securities at the election of the recipients, does the declaration of the dividend need to be registered under the Securities Act?

Answer: No, as there is no sale of the dividend shares under the Securities Act. [Nov. 26, 2008]”

If a client calls his or her corporate and securities counsel, explaining that the client wishes to declare a dividend that is payable in either cash or securities at the election of the recipients and asking whether the client needs to register

such declaration under the Securities Act, based solely on Q&A 103.01, counsel might advise such client that, no, registration is not necessary, because there has been no sale of securities.

If the same client inquires as to why registration is not required, when the cash that is paid pursuant to the dividend could be used to purchase new shares, the counsel might conduct additional research and identify SEC Release No. 33-929. SEC Release No. 33-929 states a conclusion that appears to hinge on the absence of “consideration” or (to use the terminology in Section 2(a)(3) of the Securities Act) “value.” Accordingly, counsel might advise the client that registration of the cash-stock dividend is unnecessary because, on the client's facts, the stockholders are giving no consideration or value in exchange for the dividend shares. Counsel might explain to the client that the concept of consideration is broad and includes not only the giving of money but also, for example, the forbearance of a vested right to do or receive something.

The client, or counsel, then poses a follow-up question: If the absence of consideration and the logic set forth in SEC Release No. 33-929 underlies the Division's rationale in Q&A 103.01 in determining what constitutes a sale, then why is a Section 3(a)(9) registration exemption available in the scenario described by Q&A 125.04? Q&A 125.04 asserts that a Section 3(a)(9) registration exemption is available for the conversion of preferred stock into common stock, even where a condition of such conversion is the waiver by the preferred stockholders of accrued but unpaid dividends on the preferred stock.

The final paragraph of SEC Release No. 33-929, states, in pertinent part,

“...upon the public declaration of a cash dividend out of surplus, the holders of the stock in respect of which the dividend is declared acquire immediately the rights of creditors of the corporation, and cannot be divested of these rights by subsequent action of the board of directors. If, therefore, there is declared a cash dividend payable to all stockholders, and if the board thereafter determines to grant to stockholders the opportunity to waive their pre-existing and vested right to payment of the dividend in cash, and to receive the dividend in the form of securities, the stockholders electing to take securities would in my opinion be regarded as giving value for the securities so received.”

Identifying relevant “transaction differentiators” requires a close textual reading of applicable rules and regulatory interpretations and a mindset conditioned to asking “what if.”

Based on SEC Release No. 33-929, one might have thought that the preferred stockholder described in Q&A 125.04 would have been in the position of a creditor of the corporation and that the waiver by such preferred stockholder of the accrued but unpaid dividends owed by the corporation to such stockholder would constitute the giving by such stockholder of consideration or “value.”

Section 3(a)(9) of the Securities Act provides the following exemption from registration:

“Except with respect to a security exchanged in a case under title 11 of the United States Code, any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange;”

If, in Q&A 103.01, there was no sale because no consideration was given by the stockholder, then why doesn't the waiver of a vested right to receive dividends constitute consideration (or, to use the language of Section 3(a)(9) “remuneration”), and, if it does, then how is one to explain this unanticipated result?

Read narrowly, Section 3(a)(9) would seem to posit that a security that is exchanged by a corporation with its existing stockholders is exempt from registration under the Securities Act, provided that no additional consideration is given for such exchanged security. If that is Section 3(a)(9)'s proper interpretation, then, in Q&A 125.04, it would appear that a condition to the Section 3(a)(9) exemption would not be met, because the waiver by the preferred stockholders of accrued but unpaid dividends on the preferred stock would have constituted additional consideration or “value” for the exchanged security. Accordingly, because the Division has indicated in that the Section 3(a)(9) exemption is available in the scenario described in Q&A 125.04, does that mean that the words “no commission or other remuneration” do not include “value” that is derived from and attributable to an exchanged security (*e.g.* , the accrued and unpaid dividends), or, instead, does the Division's answer indicate that Section 3(a)(9) should be construed even more broadly?

Finally, suppose that the client contacts counsel later in the week, explaining that the client now would like to declare a dividend that is payable in cash or securities, at the stockholders' election, and wants to pro-rate the cash compo-

nent if the aggregate amount of cash that the stockholders elect to receive exceeds a certain, predetermined threshold. Counsel might analyze the scenario under Q&A 103.01 and SEC Release No. 33-929 and determine that there still is no sale because the stockholders gave no value, and advise the client that registration of the election feature is unnecessary. Counsel would not be incorrect in his or her determination that the text of Q&A 103.01 is clear and unambiguous. The plain meaning of such Q&A seems to suggest that, absent a sale of securities, no registration is required.

Interestingly, issuers declaring cash-stock dividends that include formulaic proration features have registered such election features. The CDI, however, makes no mention of such “precedent” registrations. In the presence of seemingly on-point SEC interpretations and guidance, how does a securities lawyer infer the need to look beyond the four corners of the CDI? In the case of registration for cash-stock dividends with proration features, by what rationale would a securities lawyer counsel a client to register the election feature?

Securities lawyers are responsible for determining the correct answer. Identifying relevant “transaction differentiators” requires a close textual reading of applicable rules and regulatory interpretations and a mindset conditioned to asking “*what if?*”

Note what is *not* said in Q&A 103.01. For instance, there is no identification of whether the issuer is a “well known seasoned issuer;” indeed, there is no description of the issuer at all. There is no indication of whether the cash

component of the cash-stock dividend includes a proration feature, nor is there any information concerning the magnitude of the dividend. For that reason, it is tempting to assume that Q&A 103.01 is generalizable across a multitude of issuers and across any number of cash-stock dividend transactions. In reality, this and other Q&As could be narrow in application and apply only to transactions where there are no “added characteristics,” such as proration features, or the answer may be somewhere in between.

It may be and often is difficult to determine at which point one reaches the end of a particular inquiry. Just as one researches case law in a contract dispute, however, one must carefully research recent “peer” transactions and filings and keep abreast of corporate governance periodicals and trends. As the scenario presented above demonstrates, the CDI should be viewed as a starting point, not necessarily the final answer. The final step may vary depending upon the proposed transaction and may include requesting from the Division a no-action letter.

“Precedent” transactions may supplement, lead, and shape the law and potentially could result in new Division guidance. The Division’s rationale may not always be comprehensive and forward-looking, and, due to developments of new “transaction features,” laws, and other shifts, may not be consistent over time. There may be important, yet unstated and even unconsidered, transaction features that would change the SEC’s answer. At what point can a securities lawyer be confident in counseling a client that a proposed scenario complies with securities laws? There is no easy answer, except that as securities lawyers, you must be vigilant. Beware of the easy answers that you find. Beware of “clarity.”

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2009 Amendments to Delaware Corporation Law

On April 10, 2009, the governor of Delaware signed into law several amendments to the Delaware General Corporation Law (DGCL). The amendments, which will go into effect on August 1, 2009, provide for changes in several key areas including the right of access to proxy solicitation materials; proxy expense reimbursement; retroactive elimination of indemnification or advancement of expenses; record dates; and the judicial removal of directors. It is important to note, however, that with respect to the amendments relating to proxy access and expense reimbursement, the amendments merely authorize the adoption of bylaws addressing these issues and do not impose any requirements on corporations.

- **Access to Proxy Solicitation Materials (new §112)** – Stockholder access to a corporation’s proxy statement has been debated at the state and federal level in recent years. Prior to the effectiveness of the amendments to the DGCL, a Delaware corporation has had no obligation to include stockholder nominees in the corporation’s proxy solicitation materials. Stockholders seeking to nominate candidates for election to the board of directors have been obligated to prepare and mail a separate proxy statement from the corporation’s proxy statement, which generally results in the stockholder incurring significant costs.

New Section 112 of the DGCL will allow (but not require) a corporation’s bylaws to provide that if a corporation solicits proxies for an election of directors, individuals nominated by stockholders also be included in the corporation’s proxy solicitation materials, including any form of proxy distributed by the corporation.

Delaware’s adoption of Section 112 coincides with renewed review by the Securities and Exchange Commission (SEC) of federal proposals regarding shareholder access. Earlier this month, SEC Chairman Mary Shapiro announced that in May, the SEC also will consider a proposal regarding shareholder proxy access. The SEC will examine the issue with “fresh

eyes” and take into consideration the 2009 amendments to the DGCL and previous proposals made by the SEC in 2003 and 2007. Chairman Shapiro stated that the SEC wants to ensure that any procedural requirements for access are rational and ensure that a corporation’s stockholders have a meaningful opportunity to nominate directors. The proposals may set forth a minimum ownership threshold that must be satisfied by a stockholder in order for its nominees to be included in the corporation’s proxy material, or may leave such threshold or other rules to be set by the states independently, which the amendments to the DGCL would accommodate.

The new requirements under Section 112 provide that to the extent that a bylaw is adopted, the obligation to include stockholder nominees will be subject to any lawful procedures and conditions that are set forth in the bylaw adopted by a corporation. The non-exclusive list of conditions include:

- A requirement for minimum record or beneficial ownership of shares and duration of ownership by the nominating stockholder. The minimum threshold may define beneficial ownership to include ownership of options, derivative rights or other similar rights. This requirement seeks to prevent manipulation of the election process by stockholders with only a nominal or transitory interest in the corporation.
- A provision providing that specified information concerning the stockholder and its nominees is to be included in the proxy solicitation materials.
- A condition of eligibility upon the number or proportion of directors nominated by stockholders or whether the stockholder previously sought to require inclusion. Section 112 was not intended to be used to effectuate a change in control of a corporation. As such, a bylaw may condition eligibility for a limited number or “short slate” of seats.
- A condition precluding nominations by a person if such person acquired shares representing a certain percentage of the corporation’s voting power within a certain period before the election of directors. Thus, the corporation can preclude nominations relating to an acquisition of a significant percentage of the corporation’s stock, such as in connection with a tender offer or other acquisition related to a change in control.

The amendments, which will go into effect on August 1, 2009, provide for changes in several key areas including the right of access to proxy solicitation materials; proxy expense reimbursement; retroactive elimination of indemnification or advancement of expenses; record dates; and the judicial removal of directors.

- A requirement that the nominating stockholder indemnify the corporation for false or misleading information submitted by the stockholder in connection with the nomination.
- **Proxy Expense Reimbursement (new §113)** – In 2008, the Delaware Supreme Court ruled on two certified questions of law from the SEC related to a stockholder-proposed bylaw that would have required reimbursement of stockholders in connection with a successful proxy solicitation. *See CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008). The Supreme Court held that a stockholder bylaw amendment proposal that provides for reimbursement of the stockholder by a corporation for proxy expenses may be a valid proposal since it is procedural in nature. However, the Delaware Supreme Court struck down the proposal in question because, if adopted, the directors would be committed to reimburse expenses in all circumstances and thus directors would be prevented from fully discharging their fiduciary duties. Thus, because the proposed bylaw did not contain a fiduciary out, it was held to be invalid.

To address this decision, newly adopted Section 113 of the DGCL permits the bylaws of a corporation to provide for reimbursement of reasonable expenses incurred by a stockholder in the solicitation of proxies for the election of directors. Section 113 does not include a fiduciary out; however, in light of the Delaware Supreme Court’s decision in *CA v. AFSCME*, courts may read a fiduciary duty into a bylaw provision if such a carve-out is not included in a proposed bylaw.

Section 113 includes a non-exclusive list of conditions that the corporation may impose on stockholders that effectively reward a stockholder for a successful proxy solicitation. The lawful conditions that may be imposed include:

- conditioning reimbursement eligibility upon the number or proportion of persons nominated by the stockholder seeking reimbursement or whether the stockholder had previously sought reimbursement for similar expenses
- limiting the amount of reimbursement based upon the proportion of votes cast in favor of any of such stockholder's nominees or based on the amount spent by the corporation in soliciting proxies, and
- imposing limits concerning elections of directors by cumulative voting.

Any bylaw would only apply to elections following the date of the adoption of the bylaws.

- **Prohibition of Retroactive Elimination of Indemnification or Advancement (amendment to §145(f))** – Under the amendment to Section 145, the right to indemnification or to an advancement of expenses cannot be eliminated once an act or omission has occurred giving rise to proceedings for which the indemnification or an advancement of expenses is sought, unless an amendment after the occurrence of the act is expressly permitted in the certificate of incorporation or bylaws.

This amendment changes the rule set forth in *Schoon v. Troy Corp.* 948 A.2d 1157, 1165-1166 (Del. Ch. 2008), which provided that an amendment may be made following the occurrence of the act or omission that is the subject of the proceeding for which the indemnification or advancement is sought as long as it is prior to the commencement of the underlying proceeding itself. In *Schoon*, a plaintiff director had retired from the company. Thereafter, the company amended its bylaws to eliminate the company's obligation to advance fees to former directors. The company later sued the plaintiff directors for acts that the company alleged were committed during their tenure as directors. The Chancery Court held that the director did not have a vested right in the indemnification provisions as of the date of resignation and that such rights only trigger at the time a lawsuit is commenced in which the indem-

nification would be called upon. However, by that time, the bylaws had been amended so that they no longer provided former directors with indemnification rights.

The *Schoon* opinion had resulted in several corporations amending their bylaws or certificate of incorporation to override the court's decision. The amendment to Section 145 of the DGCL will statutorily eliminate the concerns raised by the *Schoon* opinion.

- **Separate Record Dates (amendments to §211(c), §213(a), §219, §222(a), §262)** – A series of amendments to the DGCL will allow the board of directors to set separate record dates for determining which stockholders are entitled to notice of any meeting (which remains unchanged under the DGCL of not more than 60 and not less than 10 days before the date of the meeting) and for determining which stockholders are entitled to vote. There is no statutory requirement as to how close the record date may be to the meeting date. By allowing a corporation to set another later record date relating to voting close to the meeting, the amendment attempts to have voting at a meeting more accurately reflect the stockholder base with an economic interest in the corporation at the time of a meeting. The record date for determining the stockholders entitled to vote must be set forth in the written notice of the meeting.

If the record date for determining which stockholders are entitled to vote is less than 10 days before the date of the meeting, the list of stockholders required to be prepared and made available prior to the meeting must only reflect the stockholders entitled to vote as of the tenth day before the meeting date. Delaware's appraisal statute also is being amended to clarify that the record date related to appraisal proceedings is the record date to determine stockholders entitled to receive notice of the meeting.

These amendments were adopted to address in part "empty voting," which occurs when stockholders, through various financial or contractual arrangements, are able to acquire voting power without a corresponding economic interest. For example, this can occur in connection with a short selling strategy whereby an investor borrows shares prior to the record date; sells the shares between the record date and the stockhold-

ers meeting; votes in a manner to effect a decrease in the company's stock price, such as voting down a merger; and, after the stockholders meeting, purchases stock at the lower price in order to fulfill its short sale contract for stock that it sold at a higher price prior to the stockholder meeting. Such arrangements by stockholders may improperly influence elections because stockholders may not vote in a manner that maximizes their economic ownership in the corporation or may fail to vote because they no longer have an economic interest in the corporation.

- **Judicial Removal of Directors (amendment to §225(c))** – Section 225 governs contested elections of directors. The amendment to Section 225(c) will grant a corporation the ability to request the removal from office of a director convicted of a felony in connection with the duties of the director to the corporation or if there is a prior judgment on the merits that a director

has breached its duty of loyalty to the corporation. The corporation may seek such removal directly or pursuant to a derivative suit by a stockholder or a member of a non-stock corporation on the corporation's behalf. The court may order the removal of the director only if it determines that the director did not act in good faith in performing the acts resulting in the conviction or judgment and that removal is necessary to avoid irreparable harm to the corporation.

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