ANALYSIS OF THE 2008 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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CORPORATION

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INTRODUCTION

There were only a few amendments to the Delaware General Corporation Law in 2008. The amendments broaden the Delaware Court of Chancery's power to fashion a remedy for stockholders who are denied access to the corporation's stock list before or during a stockholder meeting, permit a corporation to apply to the Delaware Court of Chancery for a determination of the voting results of stockholder actions other than certain elections, and increase certain filing fees and franchise taxes payable to the Secretary of State of the State of Delaware. Unless otherwise noted, all amendments took effect on June 26, 2008.

2008 also marked a significant milestone for a 2007 amendment to the Delaware Constitution, which expanded the Delaware Supreme Court's jurisdiction by permitting it to answer questions of law certified to it by the United States Securities and Exchange Commission (the "SEC"). In July 2008, the Delaware Supreme Court, for the first time, exercised its new jurisdiction to answer questions posed by the SEC on a stockholder proposal submitted to a Delaware corporation under SEC Rule 14a-8. In its decision, *CA, Inc. v. AFSCME Employees Pension Plan*, Del. Supr., 329, 2008 (July 17, 2008) (*en banc*), the Supreme Court held that a bylaw proposed for adoption by stockholders, which would have required the corporation to reimburse stockholders for proxy expenses incurred in certain future director election contests, was not permitted by Delaware law. This article describes each of the 2008 amendments and then summarizes the Supreme Court's recent *CA* decision.[1]

MEETINGS, ELECTIONS, VOTING AND NOTICE

List of stockholders entitled to vote; penalty for refusal to produce; stock ledger [§219].—The 2008 amendments change the potential remedies available to a stockholder who has been denied access to the corporation's stock list before or during a stockholder meeting. Section 219(a) requires a corporation to prepare a list of the name, address and stock holdings of each stockholder entitled to vote at an upcoming meeting and requires the officer who has charge of the stock ledger to make the list available for stockholder

1. This article supplements prior reports published by Aspen Publishers and its predecessor, Prentice Hall Law & Business, describing amendments to the Delaware General Corporation Law enacted in each of calendar years 1967; 1969; 1970; 1973-74; 1976; 1981; 1983-1988; and 1990-2007. The authors of one or more of the prior reports are: S. Samuel Arsht; Walter K. Stapleton; Lewis S. Black, Jr.; A. Gilchrist Sparks, III; Frederick H. Alexander; Jeffrey R. Wolters; and James D. Honaker.

examination for "any purpose germane to the meeting" at least 10 days before the meeting, either on a "reasonably accessible" electronic network or during ordinary business hours at the corporation's principal place of business. Under Section 219(a), a corporation must also make the list available for stockholder examination during the meeting.

Prior to the 2008 amendments, Section 219(b) specified that if the directors willfully neglected or refused to make the list available in the manner required by Section 219(a) for a meeting to elect directors, the directors would be ineligible for election to any office at the stockholder meeting. The pre-amendment version of Section 219(b) created uncertainty on the meaning of the "wilful neglect" standard and did not afford a stockholder an express remedy if he or she were denied access to the stock list for a meeting at which directors were not elected. The 2008 amendments address these concerns by enacting an entirely new remedial scheme if the corporation fails to produce a stock list. As amended, Section 219(b) permits a stockholder to apply to the Delaware Court of Chancery to compel the production of a stock list if the corporation or any of its officers or agents refuses to produce the list in accordance with Section 219(a). In such an action, the corporation will bear the burden of proving that the stockholder should be denied examination rights because the stockholder's purpose for examining the stock list is not germane to the meeting. Amended Section 219(b) empowers the Court of Chancery to order the corporation to permit examination of the list on any conditions the Court deems appropriate and to "make such additional orders as may be appropriate," including an order postponing the meeting or voiding the results of the meeting.

The 2008 amendments also enact a technical amendment to Section 219(a) by specifying that the stock list may be "examined" by any stockholder during a meeting. Prior to this change, Section 219(a) referred to the stockholder's right to "inspect" the stock list during the meeting. The change conforms this provision to the other part of Section 219(a) that refers to a stockholder's right to "examine" the stock list prior to the meeting.

Contested election of directors; proceedings to determine validity [§225].—Section 225 is the primary vehicle by which stockholders and directors can get a court ruling as to the results of a director election or other matters voted on by stockholders. In 2008, Section 225 was amended to authorize the corporation itself to bring an action seeking a ruling on non-election matters voted on by stockholders. Specifically, the 2008 amendment to Section 225(b) enables a corporation to apply to the Delaware Court of Chancery to determine the result of any vote on any matter submitted for a vote of stockholders or members of a non-stock membership corporation, unless the matter is the election of directors, officers or members of the governing body of a non-stock membership corporation. Prior to the 2008 amendments, only a stockholder or member of a non-stock membership corporation could apply to the Court of Chancery for such a determination. Amended Section 225(b) may prove to be a useful tool in the current governance environment, in which stockholder activists are playing an increasing role in stockholder meetings by opposing management proposals presented for a stockholder vote.

Interestingly, the 2008 amendments do not modify the provisions of Section 225(a), which authorizes only a stockholder, director, member of a non-stock corporation and certain officers to apply to the Court of Chancery to determine the validity of an election, appointment, removal or resignation of a director, officer or member of the governing body of a non-stock membership corporation. In prior cases, the Court of

Chancery has questioned whether a corporation has standing under Section 225(a) to bring an action to resolve contests over directorships and other corporate offices. *See Insituform of North America, Inc. v. Chandler*, 534 A.2d 257 (Del. Ch. 1987); *Agranoff v. Miller*, 734 A.2d 1066 (Del. Ch. 1999).

MISCELLANEOUS PROVISIONS

Taxes and fees payable to Secretary of State upon filing certificate or other papers [§391].—In the 2008 amendment to Section 391, the Delaware General Assembly increased from $60 to $100 the fee payable for filing and/or indexing with the Secretary of State of the State of Delaware an annual report of a foreign corporation doing business in Delaware. This amendment became effective as of January 1, 2008.

CORPORATION FRANCHISE TAX

Rates and computation of franchise tax [§503].—By amending Section 503, the Delaware General Assembly approved several increases in the Delaware corporation franchise tax. The increases became effective as of January 1, 2008. For corporations that compute their franchise tax pursuant to the standard, "authorized shares method" under Section 503(a)(1), the rate has been increased as follows: from $35 to $75 for authorized capital of 3,000 or fewer shares; from $62.50 to $75 for authorized capital of more than 3,000 but fewer than 5,001 shares; from $112.50 to $150 for authorized capital of more than 5,000 but fewer than 10,001 shares; and from $62.50 to $75 on each further lot of 10,000 shares or part thereof. For corporations that compute their franchise tax pursuant to the "alternative method" under Section 503(a)(2), the rate has been increased as follows: from $35 to $75 where the assumed no-par capital is less than or equal to $300,000; from $62.50 to $75 where the assumed no-par capital is greater than $300,000 but is less than or equal to $500,000; from $112.50 to $150 where the assumed no-par capital is greater than $500,000 but is less than or equal to $1,000,000; and from $62.50 to $75 for each $1,000,000 or part thereof of additional assumed no-par capital.[2]

Amended Section 503(c) also increases the minimum franchise tax from $35 to $75. The maximum franchise tax payable by a Delaware corporation for a full taxable year remains $165,000.

RECENT CASE LAW DEVELOPMENTS RELATING TO THE 2007 AMENDMENTS TO DELAWARE CORPORATE LAW

Although changes to the Delaware corporate statute were few in 2008, the year witnessed an important "first use" of a 2007 amendment to the Delaware Constitution that enabled the Delaware Supreme Court to answer questions of law certified to it by the SEC. *See* Delaware Constitution, Article IV, Section 11(8); 76 Del. Laws 2007, Chapter 37 Section 1, effective May 3, 2007 (discussed in Wolters and Honaker:

2. Under Section 503(a)(1), a corporation's franchise tax is computed based solely on the number of authorized shares stated in the corporation's certificate of incorporation. Under Section 503(a)(2), the tax is computed based on a formula that looks to the corporation's total issued shares and gross assets to calculate "assumed no-par capital." The State will charge taxes based on Section 503(a)(1) unless the corporation files a report making the calculations required by Section 503(a)(2).

Analysis of the 2007 Amendments to the Delaware General Corporation Law (Aspen 2007)). In 2008, the Delaware Supreme Court got its first chance to consider such a question. *CA, Inc. v. AFSCME Employees Pension Plan*, Del. Supr., 329, 2008 (July 17, 2008) (*en banc*). The Court took the occasion to make an important pronouncement concerning the proper division of powers between directors and stockholders under Delaware law, and in particular the limits on stockholders' ability to use bylaw amendments as a means of circumscribing board authority.

In *CA*, the SEC asked the Supreme Court to consider whether a bylaw amendment proposed for stockholder approval by AFSCME, a well-known activist pension fund and CA stockholder, was a proper subject for stockholder action under Delaware law and whether the bylaw would, if adopted, violate Delaware law. The bylaw, if adopted, would have required CA to reimburse a stockholder for its reasonable proxy expenses if the stockholder ran a short slate proxy contest (i.e., to elect candidates to fewer than half of the directorships up for election) and succeeded in electing at least one nominee to the board.[3]

AFSCME submitted the proposal for inclusion in CA's proxy materials pursuant to Rule 14a-8 of the Securities Exchange Act of 1934. In response to the proposal, CA notified the SEC of CA's intention to exclude the proposal from its 2008 proxy materials and requested a "no action letter" from the Staff of the SEC's Division of Corporation Finance confirming that it would not recommend enforcement action against CA if it excluded the proposal. CA's request was accompanied by an opinion of Delaware counsel concluding that the proposed bylaw was not a proper subject for stockholder action and would, if adopted, violate Delaware law.[4] However, AFSCME submitted a contrary opinion of its Delaware counsel.

The case was decided on an expedited basis. On June 27, 2008, the SEC asked the Delaware Supreme Court to determine whether the proposal was a proper subject for action by stockholders as a matter of Delaware law, and whether the proposal, if adopted, would cause the corporation to violate Delaware law. The Delaware Supreme Court accepted the certified questions on July 1, 2008, heard argument *en banc* on July 9, and issued a written opinion on July 17.

In answering the first question, the Court held that the bylaw proposal was a proper subject for stockholder action because its purpose and effect were primarily "procedural," relating to the regulation of the director election process. Turning to the second question, however, the Court determined that the bylaw would violate Delaware law if adopted by the stockholders because it would impermissibly limit the board's power and responsibility, in accordance with its fiduciary duties, to decline to

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3. Such "proxy reimbursement" proposals have come about as an alternative to the direct "proxy access" advocated by some activist stockholders in recent years. In general, proxy access would promote contested elections by allowing the proponent of a proxy contest to include its nominees on the corporation's proxy card, rather than having to distribute its own separate cards and proxy materials. Proxy access would therefore eliminate much of the expense of running a proxy contest. Reimbursement bylaws also seek to mitigate the expense of mounting a proxy contest by requiring reimbursement of expenses after the election.

4. The legal opinions from CA's Delaware counsel parallel two of the bases for excluding a proposal from a corporation's proxy materials under Rule 14a-8. *See* 17 C.F.R. §240.14a-8(i)(1) (permitting a company to exclude a proposal that "is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization"); 17 C.F.R. §240.14a-8(i)(2) (permitting a company to exclude a proposal that would, if implemented, "cause the company to violate any state, federal, or foreign law to which it is subject").

award reimbursement in a given proxy contest. The Court noted that, under Delaware law, a board cannot reimburse a proxy contestant for its expenses where the contest does not involve "questions of policy as distinguished from personnel [or] management." Further, the proposed bylaw contained "no language or provision that would reserve to CA's directors their full power to exercise their fiduciary duty to decide whether or not it would be appropriate, in a specific case, to award reimbursement at all." In reaching its decision, the Court held that, in order to limit the board's statutory power under Section 141(a)[5] and its concomitant fiduciary duty to take action in the corporation's best interest, such a limitation must be placed in the corporation's certificate of incorporation and not in the bylaws.

In addition to being the first use of the constitutional provision allowing certification of questions to the Delaware Supreme Court by the SEC, the *CA* case was also the first time that a Delaware court has ruled upon the validity of a stockholder proposal brought under Rule 14a-8. Although the decision went against the stockholder proponent under the particular facts at issue, the case may also be a victory for activist stockholders to the extent it endorsed election-related bylaw proposals provided they do not limit the board's ability to fulfill its fiduciary duties. The Court also made clear that a bylaw such as the one before it would be valid if set forth in the corporation's certificate of incorporation.

5. Section 141(a) specifies that "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."

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