

# How Del. Cos. Weighed Officer Exculpation This Proxy Season

By **Lyuba Goltser, Kaitlin Descovich and Alicia Alterbaum** (September 11, 2023)

Effective in August 2022, Section 102(b)(7) of the Delaware General Corporation Law was amended to permit Delaware corporations to exculpate covered officers, providing such officers with certain protections traditionally available only to directors.

Since then, almost 300 publicly traded Delaware corporations have amended their certificates of incorporation, or charters, to permit officer exculpation.

In this article, we evaluate the results of the 2023 proxy season, a year after the amended DGCL provisions took effect.

We also take stock of the factors that influenced the voting outcomes, including Institutional Shareholder Services and Glass Lewis & Co. 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 of 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, not against derivative claims brought by the board of directors.

Covered officers include any individual who:

- Is or was president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer;



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- Is or was a named executive officer identified in the corporation's filings with the U.S. Securities and Exchange Commission; or
- 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 Aug. 1, 2022, when the amendment to DGCL Section 102(b)(7) became effective, and Aug. 10, 2023, 288 Delaware corporations included a proposal in their proxy statements requesting stockholder approval for a charter amendment to adopt an exculpatory provision for officers.

Stockholders approved such proposals at 231, or 80.2%, of the 288 companies, and did not approve the proposals at 46 companies, or 16%. The results of the votes at 11 companies remain outstanding as of Aug. 10.

Generally, pursuant to Section 242 of the DGCL, a charter amendment requires the vote of a majority of holders 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 46 proposals that failed required a supermajority vote, 13 of which would have passed had the Delaware default standard applied.

Another hurdle to stockholder approval is that a charter amendment adopting officer exculpation is considered a nonroutine agenda item under New York Stock Exchange, Rule 452, which means that brokers are not able to vote uninstructed shares, resulting in broker nonvotes, which are effectively votes against this proposal.

## **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:

- Eliminate directors and officers liability for monetary damages for violating the duty of care;
- Eliminate directors and officers liability for monetary damages for violating the duty of loyalty;
- Expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness; and
- 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 a compelling rationale for the adoption is provided by the board, and the provisions are reasonable.

During the 2023 proxy season, ISS has largely recommended "for" the adoption of officer exculpation, while Glass Lewis has largely recommended "against."

ISS voting records indicate that as of Aug. 10, ISS supported 233 of the 288 company proposals, or 80.9%, and recommended against 50 of the 288 proposals, or 17.4%, with five proposals awaiting an ISS recommendation as of Aug. 10.

Moreover, of the 50 companies that received a negative recommendation from ISS, 42 received sufficient stockholder support to approve the exculpatory provision, signaling that a negative recommendation does not in most instances significantly affect the ultimate result.

The stated reasons for ISS' negative recommendations were largely fact-specific, but notably included 32 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, or 13 companies, or having a dual-class structure with no time-based sunset provision, or seven companies.

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

### **Proposal and Charter Amendment Language**

The proxy statement proposals on this matter have, for the most part, introduced the change in Delaware law and discussed the provision, including the full text of the amended DGCL, Section 102(b)(7), and specifically noting instances in which officer liability would not extend.

In addition, the proposals generally provided support for the adoption of the charter amendment. The amended provision enables company officers to exercise their business judgment without risking personal liability, allows officers to remain free of financial risk relating to unintentional missteps and provides a balance between shareholder and company interests.

The language of the charter amendments themselves is typically straightforward.

For most companies, the amendment added just a few words or sentences to the company's charter.[1]

## **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.[2]

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.

The 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, holding that a separate class vote of the nonvoting 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, and 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 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 and 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 and 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.

***Get ahead of the potential impact of broker nonvotes on nonroutine proxy proposals.***

In addition to the required disclosure of voting standards and the treatment and effect of broker nonvotes on such proposals, consider further highlighting in the proxy statement the impact of broker nonvotes and the importance of language in the proxy statement to street-name holders providing voting instructions to their brokers.

Depending on the company's stockholder base, consider engaging a proxy solicitor to help evaluate, target and solicit votes on this proposal.

***Monitor ongoing pending litigation for dual-class companies.***

Although the 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 a 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.

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[1] To review sample proposals for the adoption of charter amendments to provide for officer exculpation and the related charter provisions, see the following proxy statements filed with the SEC: Petco Health and Wellness Company, Inc., DEF14A filed 5/12/2023, available at [https://www.sec.gov/ix?doc=/Archives/edgar/data/1826470/000119312523142884/d449706ddef14a.htm#txa449706\\_1d](https://www.sec.gov/ix?doc=/Archives/edgar/data/1826470/000119312523142884/d449706ddef14a.htm#txa449706_1d) (see page 57); and Wyndham Hotels and Resorts, DEF14A filed 3/28/2023, available at [https://www.sec.gov/ix?doc=/Archives/edgar/data/1722684/000114036123014281/ny20006873x501\\_def14a.htm](https://www.sec.gov/ix?doc=/Archives/edgar/data/1722684/000114036123014281/ny20006873x501_def14a.htm) (see page 63).

[2] Electrical Workers Pension Fund Local 103, I.B.E.W. v. Fox Corporation, Civil Action No. 2022-1007-JTL (Del. Ch. Nov. 4, 2022), and coordinated case In Re Snap Inc., Consolidated Litigation, Civil Action No. 2022-1032-JTL (Del. Ch. Mar. 29, 2023).